No. 88-153

Supreme Court, U.S.
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Supreme Court of the United States

OCTOBER TERM, 1987

TEXACO PETROLEUM COMPANY, ECUADORIAN GULF OIL COMPANY AND GULF OIL CORPORATION (NOW, BY CHANGE OF NAME, CHEVRON U.S.A. INC.),

Petitioners,

—vs.—

PHOENIX CANADA OIL COMPANY, LIMITED,

Respondent.

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI

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July 25, 1988

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APPENDIX A

Opinion of the United States Court of Appeals for the Third Circuit (March 30, 1988)

UNITED STATES COURT OF APPEALS,
THIRD CIRCUIT

Nos. 87-3375, 87-3389.

Argued Dec. 3, 1987

Decided March 30, 1988

Rehearing and Rehearing In Banc
Denied April 26, 1988

PHOENIX CANADA OIL COMPANY LIMITED,

Appellant in No. 87-3389,

v.

TEXACO, INC., Texaco Petroleum Company, Ecuadorian Gulf Oil Company, and Gulf Oil Corporation, now, by Change of Name, Chevron, U.S.A., Inc.

Appeal of TEXACO PETROLEUM COMPANY and Ecuadorian Gulf Oil Company.

VICTOR P. MUSKIN (argued), SALLY L. SCHNEIDER, Gruen, Muskin & Thau, New York City, Hughes & Sisk, Wilmington, Del., for Phoenix Canada Oil Co. Ltd.

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LAWRENCE R. JERZ, White Plains, N.Y., for Texaco Petroleum Co.

Before

WEIS, HIGGINBOTHAM and ROSENN,
Circuit Judges.

OPINION OF THE COURT

WEIS, *Circuit Judge*

As the beneficiary of a royalty arrangement, plaintiff Phoenix seeks compensation for its proportionate share of oil production rights in Ecuador which defendant oil companies allegedly conveyed to that government. The district court found that Ecuador had paid defendants only for unamortized capital assets and supplies but nothing for production rights. Consequently, plaintiff did not succeed on that claim. The district court, however, did award plaintiff damages for past-due royalties which had been earned but calculated improperly, finding only defendant subsidiaries liable, not their parent corporations. We will remand for further factual development of a possible agency relationship between parent and subsidiary corporations, but otherwise will affirm.

After a nonjury trial, the district court entered judgment against plaintiff Phoenix Canada Oil Company, Ltd. on its claim for recovery of the value of petroleum production rights, and in favor of Phoenix on its claim for payment of past-due production royalties. The automatic stay provision of the Bankruptcy Code, 11 U.S.C. § 362, precluded entry of a final judgment as to defendant Texaco, Inc. However, the district court entered judgment with respect to the other three defendants, certifying there was no cause for delay.

Phoenix's predecessors obtained a concession from the Government of Ecuador to explore for oil in the eastern lowlands of that South American country. Subsequently, Phoenix and a Canadian co-venturer succeeded to these exploration rights, and they, in turn, assigned a portion of their concession territory to Gulf and Texaco in exchange for an immediate cash payment and a royalty on any oil extracted. Although Gulf and

Texaco successfully produced oil in the assigned territory, a series of government actions reduced the profitability of the venture, and Gulf eventually sold its interest back to the Ecuadorian government. As a result of this sale, Phoenix's royalty base was reduced significantly. Phoenix brought this suit to recover damages for its lost royalty interests.

I.

In 1961, the Ecuadorian government granted Minas y Petroleos del Ecuador a concession to explore for oil and, if discovered, exploit the reserves found in an eleven million acre tract. In 1965, Minas entered into a contract with a consortium of Gulf and Texaco subsidiaries. Under the provisions of the agreement, the subsidiaries succeeded to Minas' exploitation rights in a portion of the original concession, a large area of land identified in the contract as the "Coca Concession".[1] In return, the subsidiaries made a cash payment to Minas' two corporate owners, Phoenix and Norsul,[2] agreeing to pay a royalty calculated at two-percent of the net value of any crude oil or natural gas produced from the area. The government formally approved the transfer, but was not informed of the two-percent royalty arrangement.

Oil was discovered in the Coca Concession in 1969, and actual production began in 1972. To transport the crude to market, the Gulf-Texaco consortium financed and constructed a 318-mile pipeline across the Andes Mountains down to the Pacific Coast. The pipeline cost the consortium $108 million.

Following the 1969 announcement that oil had been discovered, the government required renegotiation of all concession

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1 Minas apparently failed to meet the government's investment requirements for the remaining portion of its 1961 Concession area. In February 1973, the Ecuadorian government declared the non-transferred portion of the Minas Concession forfeited to the State.

2 Shortly after the Ecuadorian government granted the Minas Concession, Norsul Oil and Mining Ltd., a small Canadian corporation, acquired Minas y Petroleos del Ecuador. Two years later, at Norsul's invitation, Phoenix joined in the Ecuador operation as a co-venturer. Norsul is not a party to this appeal.

arrangements. The Coca Concession consequently was reduced in area, and the government royalties were nearly doubled from 6% to 11.5%.

In 1971, Ecuador enacted the new Hydrocarbons Law which declared that "[t]he deposits of hydrocarbons and accompanying substances . . . located in the national territory . . . belong to the inalienable and imprescriptible patrimony of the State." Although originally enacted to be prospective in effect, the new law was made retroactive when a military government took power in 1972.

The 1971 Hydrocarbons Law further reduced the size of concessions and again raised the government's royalty. In addition, the statute provided that the government's royalty and income taxes would henceforth be computed for all producers on the basis of a uniform "reference price", which could be set either by agreement with the producers or unilaterally by the government. The law also mandated governmental participation in oil production through "association contracts" to which the national oil agency, Corporacion Estatal Petrolera Ecuatoriana (CEPE), would be made a party.

The consortium requested indemnification from the government for the area that had been returned in compliance with the Hydrocarbons Law. The government refused, explaining that the payment of compensation for the return of "the inalienable interests of the Nation" was inconsistent with the petroleum policy of the "Nationalistic and Revolutionary Government of the Armed Forces."

Citing the increasing costs of doing business under the new military government, the consortium insisted that the original provisions of the 1965 contract had been frustrated and demanded renegotiation of two-percent royalty proviso with Phoenix. In early 1973, the parties reached an "Interim Agreement" to govern the calculation of the royalty payments due for the last two quarters of 1972 and the first quarter of 1973. This document, however, stipulated that the signatories were not waiving their rights under the original 1965 contract.

Although the Interim Agreement expired after the first quarter of 1973, its terms were followed through the third quarter of 1973. A dispute between the parties arose when the consortium

continued to calculate the two-percent royalty under the Interim Agreement for the final quarter of 1973 and the first and second quarters of 1974. The district court's ruling on that point is one of the issues in this appeal.

The Interim Agreement renegotiation drew the government's attention to the previously unknown two-percent royalty arrangement. The Ecuadorian Natural Resources Minister reacted with hostility to the news of the discovery, declaring it an "illegal" and "immoral" attempt to partition a national resource belonging inalienably to the people of Ecuador. Rather than voiding the royalty outright, as the Resources Minister urged, the government instead imposed an 86% retroactive tax on the payment of the two-percent royalties.

In 1973 the government issued a decree establishing the terms of a new model contract, which the consortium and other oil producers were bound to accept in lieu of existing agreements. The model contract granted CEPE the right to acquire up to a 25% participation in the "rights and actions conferred in this contract and in the assets acquired by the contractors for purposes of this agreement." Also included were a tax reference price unilaterally set by the government, a provision shortening the Coca Concession exploitation period, and an expansion of state-imposed discounts for oil purchased for domestic use in Ecuador.

Consortium efforts to negotiate a mutually advantageous purchase price for the 25% interest proved unavailing. Instead, the government stated flatly that CEPE would begin its 25% participation on June 6, 1974 and that compensation would be computed on the basis of net book value, or the unrecovered actual investment in producing and pipeline assets. An independent auditor was engaged to establish the exact value of the unrecovered investment. The government rejected the consortium's request to be paid for future production rights lost as a consequence of the transfer.

The following year, a resolution announced that CEPE would not pay for its proportionate share of the cost of the pipeline. In conducting its 1976 audit, Peat, Marwick, Mitchell & Company excluded the pipeline expenditures and calculated the net book value of the consortium's investment at $182 mil-

lion. Over a nearly five-year period, Ecuador paid the consortium one-fourth this sum, or a total of $45,033,671. No interest was paid for the delay.

While the CEPE acquisition proceeded, other significant events were taking place as well. In June 1974, the government issued Resolution 11927 to clarify the two-percent royalty due Phoenix and Norsul from the consortium. The expressed purposes of this resolution were to "terminate the disagreements arising out of the assessment and payment of two-percent of the net production" and to "establish with certainty the taxable base which generates the [86%] income tax."

The Resolution imposed an additional requirement that Phoenix and Norsul invest at least half of their remaining 14% after-tax royalty payments in Ecuador. The Resolution also provided that CEPE's newly acquired 25% interest "be excluded, in order to carry out the assessment of the 2%." When challenged by Texaco, the Resolution was affirmed by a Ministerial Sentencia in October 1974.

In the years that followed, the government of Ecuador took other drastic steps which further diminished the profitability of the consortium's Coca Concession venture. One new requirement directed that the consortium deposit all export proceeds with the Ecuadorian Central Bank in order to ensure the government its petroleum royalties.

Income tax rates rose to 71.5% in 1975. Ecuador nearly tripled its government oil royalty to 17%, announcing that the royalty would be computed on the basis of "presumed", rather than actual, petroleum production. The figure the government assigned to this "presumed" production not only exceeded actual output, but was greater than the maximum volume of oil the consortium was legally permitted to produce. Finally, CEPE began extracting and selling more than its 25% share of crude, without the authorization of, or compensation to, the consortium. When Gulf protested these practices, the state threatened forfeiture.

When its relationship with the government continued to deteriorate, Gulf decided to withdraw from the consortium by sell-

ing its remaining 37.5% interest[3] to CEPE. The sale price was to be calculated on the basis of the unrecovered actual cost of Gulf's investment in producing assets, its materials and supplies inventory, and its undepreciated and unamortized interest in the pipeline. The accounting firm of Deloitte, Haskins and Sells performed the audit on Gulf's assets, listing its total share as $118 million.

CEPE made two payments to Gulf: one in May 1977 and a second in April 1979. No part of these payments was forwarded to Phoenix or Norsul. Following CEPE's acquisition of Gulf's Coca Concession interest, Gulf ceased paying royalties to Phoenix and Norsul. Texaco, however, continued its petroleum production activities on the Coca Concession and continues to pay its 37.5% share of the royalties.

Phoenix brought this suit in 1976, contending that the consortium's 25% sale to CEPE included payment for lost production rights. Phoenix claimed a share of the sale's proceeds corresponding to its lost royalty expectation. It made similar claims as to Gulf's 37.5% sale to CEPE in 1976.

Phoenix asserted its claims under theories of unjust enrichment, breach of contract, and breach of fiduciary duty. Finding that the law of Ecuador controlled, the district court allowed the case to proceed on a theory of Ecuadorian civil law known as "de in rem verso," analogous to an action for unjust enrichment. This restitution theory, the court ruled, subsumed Phoenix's quasi-contract claim. The court rejected Phoenix's claim for breach of fiduciary duty as untimely pressed.

After years of discovery and extensive pretrial proceedings that included a grant of partial summary judgment, the case reached trial in September 1986. Following a month-long bench trial, the district court prepared a thorough opinion reciting its

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3 At the time of its withdrawal from Ecuador, Gulf's share in the original Minas Concession had been reduced to 37.5%. Under the terms of the 1965 contract with Phoenix and Norsul, Gulf and Texaco had each acquired a 50% interest in the Coca Concession. In 1974, CEPE's 25% participation had reduced the consortium's share to 75% and, thus, each consortium member's share had been reduced to 37.5%. Following Gulf's withdrawal, CEPE retained a 62.5% interest in the Coca Concession and Texaco retained a 37.5% interest.

extensive findings of fact and conclusions of law. *Phoenix Canada Oil Co. Ltd. v. Texaco, Inc.*, 658 F.Supp. 1061 (D.Del.1987) (*Phoenix IV*).

The district court ruled that Phoenix could not succeed on its unjust enrichment claim because neither the consortium in its joint 25% transfer in 1974 nor Gulf in its 37.5% sellout in 1977 had received any compensation for lost production rights or future profits. The government of Ecuador had expressly intended to pay only for the depreciated and amortized book value of the acquired assets, plus the book value of their material and supplies inventory. "It was contrary to the political philosophy of the Government of Ecuador in 1974 and in 1977 to pay for the oil reserves, which were the property of the State, the rights to exploit those reserves, or the future profits that might be earned from those reserves." *Phoenix IV*, 658 F.Supp. at 1078. Because Phoenix was not entitled to share in the value of the consortium's assets, the claims for unjust enrichment failed.

The court found in favor of Phoenix on its breach of contract claim that the consortium had improperly calculated the royalties due for the final quarter of 1973 and the first two quarters of 1974. The consortium had computed the two-percent royalty during those quarters on the basis of the price of West Texas sour crude oil as adjusted for transportation costs. This calculation proved especially advantageous for the consortium because, although the world price of oil rose dramatically during this period, federally-imposed controls capped the cost of West Texas crude at a rate far below world market levels.

The court concluded that the consortium's application of the West Texas price breached the parties' 1965 contract. Because the higher Ecuadorian government reference price was the proper basis for calculating the two-percent royalty, Phoenix had been underpaid by $365,479. To that sum, the court added prejudgment interest of $532,608.71—computed in accordance with the escalating Ecuadorian rates—for a total judgment of $898,087.71. Phoenix's claim for consequential damages, consisting mainly of attorney's fees, was denied because it had not been included in the pretrial order. This appeal followed.

Phoenix contends here that the district court erred in equating the amounts CEPE paid to the consortium with the interests actually transferred. In Phoenix's view, the consideration defendants received included reimbursement for future petroleum production rights. Because Phoenix's royalty arrangement entitled it to a share of the future Coca Concessions production proceeds, it claims a right to a portion of CEPE's payments. Phoenix also challenges the district court's decision to foreclose its quasi-contract and breach of fiduciary duty causes of action.

Additionally, Phoenix asserts that the district court erroneously computed the underpaid 1973-74 royalties by excluding CEPE's 25% interest from the royalty volume base. Phoenix argues that its overdue royalty should be computed on the basis of the entire Coca Concession, with CEPE's 25% share included. Finally, Phoenix appeals the district court's refusal to consider its claim for consequential damages.

Phoenix insists, as well, that in exonerating Gulf Oil Company and Texaco, Inc., the district court erred because it failed to consider that the parent corporations of the Ecuadorian subsidiaries were actively involved in negotiating the breached 1965 contract and subsequent transactions. Phoenix seeks to hold the parents liable for their subsidiaries' actions.

Defendants cross-appeal. They maintain that the district court incorrectly read Ecuador's Resolutions as assigning the government's tax reference price—rather than the federally-capped West Texas crude price—to the two-percent royalty calculation. As a consequence, they argue that the court improperly ruled in Phoenix's favor on the breach of contract claim. Defendants also assert that the district court erred in its interpretation of Ecuadorian law on prejudgment interest.

II. *PHOENIX'S APPEAL*

A. *Unjust Enrichment Claim*

In 1983 and 1984 pretrial rulings, the district court determined that the law of Ecuador would govern Phoenix's unjust enrichment claim and that, under Ecuadorian law, the claim would proceed as an action *de in rem verso*. The parties have not challenged either determination. An action *de in rem verso*

consists of five elements: (1) enrichment of the defendants; (2) loss to the plaintiff; (3) lack of justification for the enrichment; (4) no other legally available remedy; and (5) absence of a law barring the action. *Phoenix Canada Oil Co. Ltd. v. Texaco, Inc.*, No. 76-421, slip op. at 10-11 (D. Del. July 20, 1984) (unpublished) (*Phoenix III*) [Available on WESTLAW, 1984 WL 5409] [quoting 4 Alesandri & Somarriva, Curso de Derecho Civil ¶ 1233 (1942), as translated by R. Medina, Chief, Hispanic Law Div., Law Library, Library of Congress).

To succeed on this cause of action, a plaintiff must thus prove that the defendant experienced an enrichment, and that this enrichment is unjust or illegitimate. Moreover, the defendant's increase must correspond to the plaintiff's becoming poorer: a causal relationship must exist between the defendant's enrichment and the plaintiff's loss. *Id.*

Phoenix did not advance funds for the purchase of any equipment used in the oil production; nor did it invest in inventory or other necessary materials or supplies. Phoenix's interest, therefore, was confined simply to a two-percent share of actual petroleum production. Unquestionably, Phoenix lost some of its future royalty interests when the consortium transferred a portion of their Coca Concession exploitation rights to CEPE. That fact, however, does not establish the defendants' enrichment at Phoenix's expense.

Phoenix does not dispute that the value the independent auditors assigned for the 1974 and 1977 transfers included no specific allowance for future production rights, nor was any value assigned to them. Phoenix argues that both conveyances used the word "rights" to describe the subject of the contracts and, therefore, more than mere physical assets were intended to be transferred. Phoenix maintains that CEPE purchased both physical assets and future production rights in 1974 and 1977, using the net book value figure merely as the measure of the purchase price. The district court carefully considered this argument, but rejected it as unpersuasive.

The fact that CEPE's acquisition prices corresponded exactly to the investments' book values militated against Phoenix's assertion. In addition, testimony given by the former Ecuadorian Natural Resources Minister and his legal advisor belie Phoe-

nix's conclusion. These officials restated the Ecuadorian government's consistent position that the petroleum reserves belonged to the State. In their view, Ecuador "did not have to pay for something that was its own property." *Phoenix IV*, 658 F.Supp. at 1071. "It was an act of full sovereignty so that it did not pay one single cent and it had no reason to do so." *Id.* This testimony, considered along with the course of the government's dealings with the Texaco-Gulf consortium in the early 1970s and the State decree declaring all petroleum reserves the patrimony of the nation, is compelling evidence that Ecuador had no intention of compensating the consortium for their lost production rights.

Phoenix points to large profits the consortium realized over the years from its Coca Concession venture as a justification for an equitable redistribution of the proceeds from the 1974 and 1977 sales. This argument blurs the proper legal focus. The defendants' net gains are irrelevant in an unjust enrichment analysis. "Profits, no matter how large, do not constitute unjust enrichment unless they equitably belong to another person." *Harris v. Sentry Title Co.*, 715 F.2d 941, 950 (5th Cir.1983), *cert. denied*, 469 U.S. 1037, 105 S.Ct. 514, 83 L.Ed.2d 404 (1984). The terms of its 1965 contract entitle Phoenix to a two-percent royalty of net petroleum production—not a share in the profits.

Finally, Phoenix cites paragraph 2.13 of the 1977 conveyance, which provided: "With respect to the obligations that Gulf may have in favor of third parties and that do not appear in its accounting records, neither the Ecuadorian State nor CEPE assume any responsibility and must be taken care of by Gulf." This provision adds nothing to Phoenix's claim for recovery under *de in rem verso*.

Phoenix errs when it looks to the 1961 Minas Concession Agreement to determine the extent of petroleum rights Ecuador had conveyed. Even if under that Agreement the concessionaires had certain exploitation "rights", the Ecuadorian government later transformed those "rights" into a fully revokable "license" or "permit" which involved no title to the land or minerals whatsoever. By an exercise of sovereign fiat, the government—whether because of the large oil discoveries in

1971 or the accession to power of a military government in 1972—simply changed the legal dimensions of the interests under the 1961 Concession. All parties, Phoenix as well as the oil companies, lost as a consequence of this transformation.

The record contains support for the district court's factual findings, and Phoenix has failed to satisfy us that they were clearly erroneous. To the extent that the conclusions of the district court embody questions of law, we find no reversible error. Consequently, the judgment against Phoenix with respect to unjust enrichment must be affirmed.

B. *Quasi-Contract and Fiduciary Duty Claims*

Phoenix objects to the pretrial dismissal of its quasi-contract and breach of fiduciary duty claims. Neither of these claims had been fully briefed or vigorously pursued below. Phoenix never specified the elements of the claims under Ecuadorian law, nor did it explain how its allegations conformed to those elements. As the party seeking to recover under a foreign nation's cause of action, Phoenix bore the burden of proving its entitlement to that relief. *Cuba R.R. v. Crosby*, 222 U.S. 473, 479, 32 S.Ct. 132, 133, 56 L.Ed. 274 (1912).

For ten years, the district court wrestled with this case, battling a seemingly never-ending barrage of paper. In *Phoenix II*, the court characterized the pretrial condition of the case as a "hopelessly confused morass." *Phoenix Canada Oil Co. Ltd. v. Texaco, Inc.*, 560 F.Supp. 1372, 1390 (D. Del. 1983) (*Phoenix II*). By that time, seven years after the suit was filed, the court justifiably could expect Phoenix to have clarified its position and finally have settled on its legal theory. The court struggled toward narrowing the issues for trial and deserved the litigants' cooperation.

In the 1983 pretrial "wrap-up" the court ruled that the three-year statute of limitations barred recovery for all tortious acts occurring before November 26, 1973. At that stage in the litigation, Phoenix was alleging that the defendants had tortiously engaged in a continuing scheme to destroy it. However, most of the alleged activity occurred outside the statute of limitations, and was thus time-barred. As to the remaining allegations, the

court determined that the facts charged as tortious sounded in contract rather than tort.

At a pretrial conference following the 1983 ruling, the parties presented the court with a 184-page proposed pretrial order, which the court declined to accept. The parties subsequently filed additional briefing on Ecuadorian law and further argument followed. Most efforts during this period were devoted to exploring Ecuadorian law on unjust enrichment. As the court noted, only two issues not previously decided were raised: "the parameters of an unjust enrichment theory in Ecuador and that relating to a contract dispute over the three quarters of royalty payments." *Phoenix III*, slip op. at 5.

In deciding how to proceed on Phoenix's unjust enrichment claim, the court reviewed the three principal quasi-contract theories enumerated in the Ecuadorian Civil Code: the "unsolicited agency, the payment of something not owed, and the community." *Phoenix III*, slip op. at 9 (citing Civil Code art. 2212 (Ecuador)). The court stated that ambiguities in those provisions of the Code "might well lead to a statutory basis behind plaintiff's claim." Nevertheless, the court concluded that Phoenix's inability to fit its allegations squarely into one of these three civil code sections would not preclude a recovery under a "general theory of unjust enrichment." *Id.*

After further study, the court announced that Phoenix could proceed to trial on the unjust enrichment *de in rem verso* theory. The court observed also that Phoenix might have "a few lingering contract claims of minor pecuniary significance relating to the three quarters of 1973 and 1974. If plaintiff so desires, those claims, too, will proceed to trial." The court then directed the parties to submit a "manageable" proposed pretrial order. *Phoenix III*, slip op. at 18.

Phoenix later attempted to resurrect its defunct tort cause of action, this time as a claim for breach of fiduciary duty. The court permitted this count—added seven years after the original complaint was filed—to be briefed, and argued during the final pretrial conference on February 18, 1986. After consideration, the district judge directed that the trial proceed only as to the two theories outlined in the 1983 order: unjust enrichment and breach of contract. As to the belated breach of fiduciary duty

claim, the judge stated: "It would appear to me that the plaintiff is saying we acknowledge the validity of the decrees of the Ecuadorian government but the plaintiffs are entitled to go through the back door to attack the defendants for permitting the decrees to have been made."

After our examination of the lengthy history of this case, we think it appropriate to commend the district judges for their tireless efforts to narrow the issues to manageable proportions. Having carefully monitored the pretrial developments for nearly a decade, the district court's preclusion of an issue raised at the "twenty-third hour", it seems to us, was within the court's proper discretion. In any event, though not determinative, our review leads us to conclude that Phoenix had little likelihood of success on either its quasi-contract or breach of fiduciary duty theory.

In *Phoenix II*, Judge Schwartz observed that the "concept of unjust enrichment—basically an equitable premise—structurally forms the basis for theories of quasi contract." *Phoenix II*, 560 F.Supp. at 1384. *See* Kovacic, *A Proposal to Simplify Quantum Meruit Litigation*, 35 Am.U.L.Rev. 547, 554 (1986). Phoenix's own legal expert, Rene Bustamante Munoz, has explained that the same is true under the law of Ecuador. "We also consider that unjust enrichment or enrichment without cause is the foundation of all the quasi contracts mentioned by Arts. 1480, 2211 and 2212 of the Civil Code as one of the sources of obligations." (App. 804) As a result, our determination that the district court correctly rejected Phoenix's unjust enrichment claim similarly dooms its claims under quasi-contract.

There is no reversible error here.

C. *Volume Base Claim*

In its 1983 pretrial ruling, the district court granted summary judgment against Phoenix on its claim that the consortium improperly had excluded CEPE's 25% interest when computing the two-percent royalty payments. Yielding to the model contracts the government had decreed for all oil companies in 1973, the consortium reluctantly transferred 25% of its interest in the

Coca Concession to CEPE. Following this transfer, the consortium reduced by CEPE's 25% the volume base on which it calculated Phoenix and Norsul's two-percent royalty. In the district court, Phoenix contended that this reduction constituted a breach of its 1965 contract.

The district court decided that the Ecuadorian government had addressed directly the amount of oil production which legally could be subjected to the two-percent royalty. Resolution 11927 provided that "there shall be excluded, in order to carry out the assessment of the 2%[,] the percentage of CEPE in the net production." The court accorded this decree and its affirming Sentencia presumptive validity which Phoenix failed to overcome. The court rejected Phoenix's argument that the Resolution could not adjudicate private rights and that it was intended only to apply to the calculation of the government's 86% royalty tax.

Two years later, Phoenix sought reconsideration based on additional documents and the depositions of former Ecuadorian ministers. Phoenix argued that Ministry calculation sheets for 1975 revealed that the government had computed the two-percent royalty on the full 100% volume base and only then taxed at the 86% rate 75% of the volume base. After the depositions were taken and following argument by the parties, the district court denied the motion to reconsider. The court found the newly submitted calculation sheets unenlightening and concluded that the particular mathematics the government used did not change the legal basis on which summary judgment had been entered. Nor did the new evidence create any issue of material fact.

We find no reversible error in the district court's initial entry of summary judgment or its subsequent refusal to alter the ruling in light of the new evidence. Resolution 11927's "whereas" clauses stated expressly that the decree was designed "to terminate the disagreements arising out of the assessment and payment of two percent of the net production established in Clause Sixth of the private agreement signed on July 16, 1965," and also to "establish with certainty the taxable base which generates the income tax."

The taxation-only interpretation Phoenix encourages us to give Resolution 11927 ignores the government's purpose, stated in the document's first whereas clause, to resolve the disagreements between the parties. Certainly, this goal would not be accomplished if the Resolution's provisions did not apply to the untaxed, distributed portion of the royalty—that part actually in dispute among the parties. Moreover, the Resolution contains numerous provisions that clearly apply to the entire two-percent royalty, rather than to just the taxed portion.

Read as Phoenix would advocate, the Resolution would require royalty payments on the entire 100% volume base yet only 75% of the royalty payments would be subject to the government's 86% royalty tax. The government, in effect, would be foregoing its 86% tax on a quarter of all royalties paid. The obvious hostility with which the government viewed these royalty payments suggests strongly that it would not have enacted such a provision.

The deposition evidence supports the district court's entry of summary judgment on this claim. The Natural Resources Minister testified that neither CEPE nor any third party was obligated to pay the two-percent royalty on oil that belongs to the State. The Minister's legal advisor was even more specific, stating that under Resolution 11927 the consortium had the duty to pay the two-percent royalties only after deducting from the production amounts that portion belonging to CEPE.

D. *Consequential Damages*

At the conclusion of the month-long bench trial, Phoenix submitted its Proposed Findings of Fact and Conclusions of Law. Included in the submission was a request for consequential damages (attorney's fees), though such a claim did not appear in the pretrial order. The district court rejected this damage claim as belatedly raised. "This claim was not included in the Pre-Trial Order and we will not permit it to be raised now in this untimely manner." *Phoenix IV*, 658 F.Supp. at 1082.

The pretrial procedures adopted for the federal courts were formulated with the express goal of facilitating scheduling and case management. Fed.R.Civ.P. 16(a) advisory committee's

note. Particularly important in complex civil cases such as this, pretrial procedures provide the district courts with a useful tool to harness unwieldy litigation by simplifying the dispute and narrowing the issues for trial. For this reason, pretrial orders bind the parties unless modified by the court to prevent manifest injustice. Fed.R.Civ.P. 16(e). After a decade managing this enormous dispute, the district court acted within its discretion to reject a claim for consequential damages asserted after trial but not in the pretrial order. *See Trujillo v. Uniroyal Corp.*, 608 F.2d 815, 817 (10th Cir.1979); *Moore v. Sylvania Elec. Prods., Inc.*, 454 F.2d 81, 84 (3d Cir.1972).

E. *Parental Liability*

The district court entered judgment in favor of Phoenix on its breach of contract claim for undercalculated royalties for the final quarter of 1973 and the first two quarters of 1974. Phoenix also had sought to extend that liability to the parent corporations, Texaco, Inc. and Gulf Oil Corporation. The district court denied this request.

Proceeding only on the basis of an agency theory of parental liability, the district court ruled that the parent corporations would not be liable for the actions of their subsidiaries. The court found that the parents and the subsidiaries here shared several common officers and directors, though their boards otherwise were separate. The parents also participated in the substantial financial dealings of the subsidiaries, who were required to secure approval from their parent corporations for large investments and acquisitions or disposals of major assets.

On the other hand, the subsidiaries kept separate books and records, maintained their own bank accounts, paid their own taxes, and were responsible for their own day-to-day operations in Ecuador, including drilling oil wells and constructing the pipeline. Relying on *Japan Petroleum Co. (Nigeria) Ltd. v. Ashland Oil, Inc.*, 456 F.Supp. 831 (D.Del.1978), the district court concluded that "it can hardly be said that the facts presented to the court in this case show complete domination or control by Texaco and Gulf over their subsidiaries." *Phoenix IV*, 658 F.Supp. at 1085.

The relationship between parent and subsidiary corporations has been a fruitful source of litigation and although the case law on the subject is extensive, it is neither uniform nor clear. Some decisions apply an agency theory to assess parental liability, others focus on an alter ego basis, and some speak in terms of "piercing the corporate veil." Much of the confusion stems from a failure to distinguish between subsidiaries treated as independent entities and those in fact not independent, but considered part of the parent corporations.

Courts most often "pierce the corporate veil" where fraud would result if the corporate structure were allowed to shield shareholders from liability. Thus, in *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 685-87 (4th Cir.1976), the court noted that independent corporate status may be disregarded when such factors as gross undercapitalization, fraud, failure to observe corporate formalities, nonfunctioning of officers and directors, or similar circumstances indicate that the subsidiary is merely the shadow of the parent. If, as in this case, the shareholder happens to be another corporation, piercing the corporate veil results in disregard for the separate existence of parent and subsidiary.

In determining whether two corporations are truly separate, significant factors to consider include adequacy of capitalization, overlapping directorates and officers, separate record keeping, payment of taxes and filing of consolidated returns, maintenance of separate bank accounts, level of parental financing and control over the subsidiary, and subsidiary authority over day-to-day operations. *See* 1 Fletcher, *Cyclopedia of the Law of Private Corporations* § 43, at 194 (cum. supp. 1987). In that context, the concept of complete domination by the parent is decisive. *See Craig v. Lake Asbestos of Quebec, Ltd.*, 843 F.2d 145 (3d Cir.1988). The activities bearing on the issue of corporate independence need not have any particular relationship to the cause of action being asserted.

There is a second theory under which a parent may be held liable for the activities of its subsidiary: an application of general agency principles. One corporation whose shares are owned by a second corporation does not, by that fact alone, become the agent of the second company. However, one corporation—

completely independent of a second corporation—may assume the role of the second corporation's agent in the course of one or more specific transactions. This restricted agency relationship may develop whether the two separate corporations are parent and subsidiary or are completely unrelated outside the limited agency setting. *See* Restatement (Second) of Agency § 14M, comment (a) (1958). Under this second theory, total domination or general alter ego criteria need not be proven.

When one corporation acts as the agent of a disclosed principal corporation, the latter corporation may be liable on contracts made by the agent. *See* Restatement (Second) of Agency § 144 (1958). Liability may attach to the principal corporation even though it is not a party named in the agreement. *See* Restatement (Second) of Agency §§ 147, 149 (1958).[4] *See also* W. Seavey, *Handbook of the Law of Agency* § 70 (1964); W.E. Sell, *Agency* § 103 (1975).

Unlike the alter ego/piercing the corporate veil theory, when customary agency is alleged the proponent must demonstrate a relationship between the corporations and the cause of action. Not only must an arrangement exist between the two corporations so that one acts on behalf of the other and within usual agency principles, but the arrangement must be relevant to the plaintiff's claim of wrongdoing.[5]

In reaching its decision to exonerate the parents, the district court relied heavily on *Japan Petroleum*. In that case, despite

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4 Although the agency question could perhaps have been determined under the law of Ecuador, the parties acquiesced in the district court's application of Delaware Law. *Phoenix Canada Oil Co. Ltd. v. Texaco, Inc.*, 658 F.Supp. 1061, 1084 n. 43 (D.Del.1987) (*Phoenix IV*). We see no reason why we should disturb the parties' choice of law in these circumstances. Delaware agency law is consistent with the general common law. *See Japan Petroleum Co. (Nigeria) Ltd. v. Ashland Oil, Inc.*, 456 F.Supp. 831, 838-41 (D.Del.1978) (applying Restatement).

5 This limitation was acknowledged in *Fisser v. International Bank*, 282 F.2d 231, 238 (2d Cir. 1960), where the court quoted with approval one commentator's view: "Restating the instrumentality rule, we may say that in any case, except express agency, . . . three elements must be proved: (1) Control . . . not only of finances, but of policy and business practice in respect to the transaction attacked. . . ."

extensive interaction between parent and subsidiary, the court found them to be separate and, thus, held the parent not liable for the acts of its subsidiary. Apparently, the fact that the Nigerian subsidiary had powers granted by the Nigerian government that were unavailable to the parent was the decisive factor in finding the parent not liable. *Cf. Fitz-Patrick v. Commonwealth Oil Co.*, 285 F.2d 726 (5th Cir. 1960) (incorporation of foreign subsidiary to meet governmental requirement did not insulate parent from liability).

The 1978 holding in *Japan Petroleum* was not appealed by this court, and consequently we have not been called upon to examine the correctness of its analysis. Nor do we embark on a review of that case at this time. We are content with noting that the facts here are sufficiently distinguishable so that the same result would not necessarily follow. Nevertheless, because the issue is one of fact, *see* 1 Fletcher, *supra*, at § 43, at 472 (rev. perm. ed. 1983), we cannot say that the district court's finding of no complete domination here is clearly erroneous.

However, the district court did not analyze customary agency principles as another possible source of parental liability. When using that approach, the completeness of the subsidiary's domination by a parent is not material—the focus instead centers on whether the Ecuadorian corporations, though separate and independent from the United States corporations, acted as agents for disclosed principals.

In conducting this review, the focus must be directed to the pertinent cause of action. Thus, only the judgment in favor of Phoenix on the undercalculation of royalties due for the three quarters in 1973 and 1974 is relevant. The evidence of relationship between the parents and subsidiaries as it bears on that breach of contract is the proper subject of our inquiry.

We can appreciate the difficulty which the district court confronted as a result of the parties' failure to carefully identify the affiliations of many of the actors. For example, in numerous instances individuals identified with Texaco or Gulf are not specifically classified as employees of the Ecuadorian subsidiaries, of the United States' parents, or perhaps employed by one and acting on behalf of the other. Similarly, correspondence which

could prove important in assessing attribution of activity to parent or subsidiary is not definitive.

With these uncertainties in mind, we observe with some diffidence that several significant events may bear on the creation of, or absence of, an agency relationship between the subsidiaries and the parents in connection with the 1965 contract.

It appears that the parents negotiated and drafted the 1965 agreement, but it was actually executed by Compania Texaco de Petroleos del Ecuador C.A. and Gulf Ecuatoriana de Petroleos S.A. In 1969 when oil was discovered, the parents issued a joint press release announcing that they each owned a fifty percent working interest in the discovered reserves, subject to a two-percent royalty. The release said: "Texaco and Gulf obtained the Coca concession by assignment from Minas y Petroleos Del Ecuador . . . ."

When the royalty agreement underwent renegotiation in 1972, employees of the parent corporations apparently assumed a controlling role in the process. It was the parents who recommended the use of West Texas crude as the reference price for calculating the two-percent royalties.

CEPE made its 1977 buyout payment for the Gulf interest to the parent, Gulf Oil Corporation, at the parent's home bank in Pittsburgh. Although that event occurred several years after the three quarters breach of contract, it nevertheless may shed some light on the nature and extent of the control exercised by the parent as principal in earlier years. *See Verreries De L'Hermitage v. Hickory Furniture Co.*, 704 F.2d 140, 142 (4th Cir.1983).

Because the district court did not explore customary agency principles as a possible source of parental liability, we will remand for further inquiry and fact-finding to determine the applicability of those principles to the case at hand. We note that, under usual agency principles, complete domination by the parents in the general conduct of the subsidiaries' affairs is not a prerequisite. The parents and subsidiaries may fully maintain their separate corporate existences; yet, as any two unrelated companies, they might have entered into a limited agency relationship for a specific transaction. Whether this occurred here is a question of fact reserved to the district court.

III. *TEXACO AND GULF CROSS-APPEAL*

A. *Breach of Contract*

At trial, Phoenix was awarded $365,479 for its breach of contract claim for undercalculated royalties. The court ruled that, in computing the two-percent royalty, the consortium had improperly adopted the federally-capped West Texas crude price instead of the higher Ecuadorian government's tax reference price. Defendants cross-appealed from this ruling, contending that their calculations comported with the terms of the 1965 contract.

The two-percent royalty arrangement was set out in paragraph 6 of the 1965 contract. The provision states that, for all purposes of the contract, the value of the crude oil "shall be understood as the value defined in each case for the purpose of calculating the payment of the royalties which cessionaires must make to the Government." Paragraph 8, on which defendants rely, provides that the price calculations were to be made on the "same bases established for the respective payments to the Government, according to [the 1961 Minas Agreement]."

The 1961 Minas Agreement established a formula for calculating the royalty owed the government based on "the average volume of the oil in the world market." To compute his average value, the Agreement created the equation $X = A - B$, in which "X" represented the world market value, "A" represented the West Texas crude price, and "B" represented the cost of transporting the crude from Ecuador to New York.

However, the 1971 national Hydrocarbons Law explicitly superceded all existing contractual provisions on the calculation of government royalties. Article 65 of the Hydrocarbons Law stated: "Royalties in cash, income tax, government's participation and generally any assessments depending on the sale price of hydrocarbons in the foreign market, shall be regulated by the reference prices of petroleum." The government unilaterally set this "reference price."

The passage of this new law revealed a previously undetected conflict between paragraphs 6 and 8 of the 1965 contract. Paragraph 6 tied Phoenix's royalty to the value of the government royalty, a figure the 1971 Law had legislatively increased. Para-

graph 8 appeared to link the Phoenix royalty to the value of the government royalty as it would have been calculated under the 1961 Minas Agreement—the lower West Texas price.

In resolving this apparent conflict, the district court ruled that the Hydrocarbons Law had supplanted the terms of the 1961 Agreement to which paragraph 8 referred. "Once the 1971 Law was promulgated, calculation of government royalties under the 1961 Concession Contract was based no longer on . . . the 1961 Contract, but on . . . the 1971 Law." *Phoenix IV*, 658 F.Supp. at 1080. Thus, because the two-percent royalty was dependent on the amount "which cessionaires must make to the Government," the Hydrocarbons Law altered not only the calculation of the government royalty, but the calculation of Phoenix's royalty as well.

If the ambiguity of the two-percent royalty provisions of the 1965 contract has led to a result defendants had not anticipated, the fault is their own. As authors of the contract, they could have made their terms plain; their failure to do so cannot inure to their benefit. *See John F. Harkins Co. v. Waldinger Corp.*, 796 F.2d 657, 662 n. 2 (3d Cir.1986), *cert. denied*, ____ U.S. ____, 107 S.Ct. 939, 93 L.Ed.2d 989 (1987). We agree with the district court that the contract's reference to the amount paid in government royalties necessarily established a benchmark which could be altered by the State through force of law.

We have examined in detail the defendants' other contentions and we are not persuaded. We accept the view of the district court.

B. *Segmented Prejudgment Interest*

On the $365,479 breach of contract judgment, the district court awarded $532,608.71 in prejudgment interest. Defendants challenge the court's calculation of this sum.

The 1965 contract contained no prescribed rate of interest, and the parties agree that Ecuador's legal rate of interest would be applicable. Defendants contend that awards of prejudgment interest under Ecuadorian law accrue from the date of service of process. The district court accepted this starting date and then sought to apply the appropriate rate, a task complicated by

the precipitous rise in interest rates that occurred during the pendency of this litigation.

At the time the complaint was served, the legal rate of interest in Ecuador was 8%. The rate rose dramatically in five stages to 23%, the rate in effect in 1984. Modifications to the interest rates were accomplished by resolutions issued by the Ecuadorian Monetary Board. The resolutions encompassed a wide range of transactions and set varying rates for each, including such diverse items as interest payable on savings passbooks, mortgage bonds, development bonds, obligations of the central and provincial governments, interbank transactions, and various credit operations.

Article 8 of a typical resolution read: "The provisions of the present Regulation shall apply only to the acts and contracts entered into from and including the date it is published in the Registro Official. Therefore, the types of interest rates stipulated in the acts and contracts entered into prior to that date, be they drawn or to be drawn, shall continue in effect until the expiration date agreed upon in the respective act or contract."

The resolutions applied to many different types of transactions and not merely to causes of action in court. The resolutions' language must be read against their background of broad application.

In 1975, the Monetary Board issued Resolution 755 which fixed the legal interest rate at 8%. Defendants aver that this rate should apply to the entire breach of contract judgment. The district court disagreed and applied a segmented interest rate reflecting the five successive increases in the Ecuadorian legal rate.

The court acknowledged the Resolution's statement that the new rates were to apply only to agreements entered into after the date of the Resolution's publication, but held the restriction was limited to contracts providing a stipulated rate of interest. Because the contract here contained no such stipulation, the prejudgment interest rate was increased as the legal rate rose.

In so ruling, the court accepted the views of Phoenix's expert and rejected those of the defendants' experts. The court also declined to follow a decision of the Supreme Court of Ecuador, *Segovia v. Acosta*, Judgment No. 341, Third Chamber,

November 11, 1977, which presented a similar factual situation. The district court observed correctly the lack of precedential effect of judicial decisions in civil law jurisdictions.

We find no reversible error in the district court's ruling on prejudgment interest. The court properly reasoned that if the arrearages had been paid promptly, Phoenix could have taken advantage of the rising legal rates of interest in Ecuador. Pursuant to Resolution 11927, Phoenix was compelled to invest half of its after-tax royalty proceeds in Ecuador and, thus, would surely have profited from the soaring legal rates. "Prejudgment interest serves to compensate for the loss of use of money due as damages from the time the claim accrues until judgment is entered, thereby achieving full compensation for the injury those damages are intended to redress." *West Virgina v. United States*, ____ U.S. ____, ____, 107 S.Ct. 702, 706 n. 2, 93 L.Ed.2d 639 (1987).

IV. *SUMMARY*

We will affirm the judgment in favor of Phoenix for breach of contract arising out of payments due for the last quarter of 1973 and the first two quarters of 1974. On that claim, we will vacate the judgment in favor of the parent Gulf Oil Corporation (now, by change of name, Chevron U.S.A., Inc.) and remand for further proceedings consistent with this opinion. We will affirm the district court's award and calculation of prejudgment interest. Because of the automatic stay under the Bankruptcy Code, we will not enter any dispositive order as to Texaco, Inc. at this time. We will affirm all the remaining judgments in favor of defendants.

APPENDIX B

Opinion of the United States District Court for the District of Delaware (March 13, 1987)

B1

UNITED STATES DISTRICT COURT,
D. DELAWARE.

Civ. A. No. 76-421-JRR.

March 13, 1987.

PHOENIX CANADA OIL COMPANY LIMITED,

Plaintiff,

v.

TEXACO, INC., Texaco Petroleum Company and Ecuadorian Gulf Oil Company, and Gulf Oil Corporation (now, by change of name, Chevron U.S.A., Inc.),

Defendants.

Thomas D. Hughes, of Hughes & Sisk, Wilmington, Del., Victor F. Muskin, and Sally L. Schneider, of Gruen, Muskin & Thau, New York City, of counsel, for plaintiff.

William O. LaMotte, Jr., and Richard D. Allen, of Morris, Nichols, Arsht & Tunnell, Wilmington, Del., Milton Sherman, Myron Kirschbaum, Scott M. Berman, and John W. Schryber, of Kaye, Scholer, Fierman, Hays & Handler, New York City, of counsel, for defendants.

OPINION

ROTH, District Judge.

This is a diversity action, brought more than ten years ago by plaintiff, Phoenix Canada Oil Company Ltd. ("Phoenix"), claiming breach of contract, unjust enrichment, and intentional infliction of economic distress by defendants, Texaco, Inc. ("Texaco"), Gulf Oil Corporation, now by change of name Chevron U.S.A., Inc. ("Gulf"), Texaco Petroleum Company

("Texaco Ecuador"), a Delaware corporate subsidiary of Texaco, and Ecuadorian Gulf Oil Company ("Gulf Ecuador"), a Delaware corporate subsidiary of Gulf. The litigation arose from an agreement ("the 1965 Contract") by which Phoenix and Norsul Oil and Mining, Ltd. ("Norsul") assigned to Texaco Ecuador and Gulf Ecuador the rights to explore for and exploit petroleum reserves in a concession area in eastern Ecuador, in return for a payment of $100,000 plus two percent of the value of net production of crude oil and natural gas.

There have been a number of prior decisions in this case, both reported and unreported, which have narrowed and defined the issues. In *Phoenix I*, 78 F.R.D. 445 (D.Del.1978), the Court considered and denied both defendants' motion to dismiss on the basis of *forum non conveniens* and the doctrines of act of state and foreign government compulsion and plaintiff's motion for partial summary judgment.

In *Phoenix II*, 560 F.Supp. 1372 (D.Del.1983), the Court took up defendants' motion for summary judgment. On the breach of contract claim, the court granted defendants' motion, ruling that Ecuadorian law applied and that defendants did not breach the 1965 contract when Texaco Ecuador and Gulf Ecuador stopped making the two-percent payments on portions of their concession areas which were acquired by the Ecuadorian State Petroleum Corporation ("CEPE").

The Court further ruled in *Phoenix II* that plaintiff's claim, based on the allegation that defendants engaged in a continuing scheme to destroy plaintiff as an economic entity, was barred by the Delaware statute of limitations, 10 *Del.C.* § 1806, since none of the acts which would give rise to a cognizable cause of action had occurred within the three years preceding the filing of suit.

Finally, the Court denied summary judgment on the unjust enrichment claim, holding that Ecuadorian law applied, that there was a reasonable basis to conclude that Ecuadorian law recognized the concept of unjust enrichment, and that there were issues of material fact as to whether CEPE's compensation to Texaco Ecuador and Gulf Ecuador for the acquisition of its interest in the concession area reflected only the depreciated value of assets and equipment, or included compensation for

production rights, and, if so, as to whether defendants had received a benefit from the transfer to CEPE.

In *Phoenix III*, C.A. 76-142 (D.Del., July 20, 1984) [Available on WESTLAW, DCT database], the Court ruled that, if an Ecuadorian court were to allow a general unjust enrichment cause of action, the court would apply an action "*de in rem verso*", which action is comprised of five elements: (1) enrichment of defendants, (2) loss to plaintiff, (3) lack of justification for the enrichment, (4) no other available remedy, and (5) absence of law barring the remedy. *Phoenix III*, slip op. at 11 [Available on WESTLAW, DCT database]. The Court also considered in this Memorandum Opinion, plaintiff's claim that defendants miscalculated the two-percent payments during three quarters in 1973 and 1974. The Court held that there was no miscalculation. However, this latter ruling was vacated on June 11, 1985, and the claim for the three miscalculated quarterly payments was reinstated.

Trial on the claims of unjust enrichment and of underpayment for the three quarterly periods was held in September 1986. The Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

The incidents which gave rise to this litigation took place for the most part in Ecuador, a South American country which straddles the Equator. Ecuador has three major geographic regions: the lowlands of the Pacific coast, the Andes highlands where the capital, Quito, is located at an elevation of 9,200 feet, and the Oriente or eastern lowlands, a sparsely populated area, including the eastern slopes of the Andes and part of the Amazon River basin.

There had been unsuccessful exploration for oil in the Oriente in the 1920's and the 1940's. Oil exploration began again in the region in 1961. In July 1961, the Government of Ecuador granted a concession to Minas y Petroleos del Ecuador ("Minas")[1] to explore for petroleum reserves and to exploit

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1 Minas was organized as a corporation under the laws of Ecuador in 1960.

them, if discovered, in 4,350,000 heçtares (approximately 10,744,500 acres or 16,788 square miles) in the Napo, Pastaza, and Morona Santiago provinces of the Oriente region ("1961 Concession"). The grant of the 1961 Concession to Minas by the Government of Ecuador was authorized by Decree 1401, which set out the terms and conditions of the concession contract (the "1961 Contract").

Plaintiff Phoenix's involvement with the Ecuadorian concession goes back to 1961 when one Howard Steven Strouth approached S. Donald Moore, president and sole operating officer of Phoenix, in order to acquire a public company to facilitate the financing of Minas's operations. Moore introduced Strouth to the principals of a small Canadian corporation, then dormant. Strouth's group acquired a controlling interest in that company, Norsul Oil and Mining, Ltd. Minas then became Norsul's wholly owned subsidiary. From 1961 to 1971 Strouth was Norsul's major stockholder, Managing Director, and principal operating officer.

Phoenix did not itself contribute to Minas's operations in 1961. However, in 1963, Strouth again approached Phoenix to become a participant in the venture. He met with Moore in Calgary in early 1963. As a result of that meeting, Phoenix agreed to contribute certain funds to the maintenance of the concession area and further agreed that Moore would contribute oil industry expertise to Norsul, all in consideration of an undivided 30 percent interest in the concession area. According to Moore, Phoenix's interest was later increased to 60 percent.[2]

The 1961 Contract required that Minas make certain minimum yearly investments for exploration and exploitation operations and that it pay annual surface taxes. Minas did not have the capital to undertake an extensive exploration program in the area. Instead, Strouth hoped to interest a large oil company in purchasing the concession from Minas. Because Minas failed to do the required exploratory work, was habitually in arrears in meeting its financial obligations, and engaged in speculative activities, the 1961 Contract was in danger during the early 1960's of being cancelled by the Government of Ecuador.

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2 T-212 (Trial Transcript is designated "T" plus page number).

In 1964, defendants Gulf and Texaco, through Ecuadorian subsidiaries, also became involved in exploring for oil in the Oriente. The Government granted them the Napo Concession, which adjoined the Minas 1961 Concession on the north. During 1964 there were contacts between Minas and defendants concerning the possibility of a joint survey of the boundary between the Minas and Napo concessions and the acquisition by defendants of part of the Minas concession.

In January 1965, Moore arranged with Max Crawford of Texaco to meet in Trinidad to discuss a new proposal for participation by defendants in the Minas 1961 concession. Moore met with one of Texaco's principal geologists, a Mr. Martin, on January 27 to present a proposal for Gulf and Texaco to acquire a portion of the 1961 Concession. Moore took the position that because Phoenix owned 60 percent of Minas, he was the person with whom to negotiate concerning the 1961 Concession. Stroth at the same time contended that Norsul owned all the shares of Minas and that he was the one to deal with. After looking into the matter, Texaco decided to negotiate with Stroth.

Stroth had moved to Quito as a result of a condition imposed by Phoenix when it began its participation in the Minas 1961 Concession venture. In early 1965, Stroth began discussions in Quito with representatives of Texaco. On April 1, 1965, Max Crawford made an offer by letter on behalf of Texaco and Gulf to acquire from Minas 500,000 hectares of the 1961 Concession in return for a cash payment plus an overriding royalty for any production developed and exploited. This transaction would be subject to the approval of the Government of Ecuador.[3]

On July 16, 1965, Compania Texaco de Petroleos del Ecuador, C.A. ("Texaco del Ecuador"), an Ecuadorian subsidiary of Texaco Ecuador, and Gulf Ecuatoriana de Petroleo, S.A. ("Gulf Ecuatoriana"), an Ecuadorian subsidiary of Gulf Ecuador, contracted with Minas to acquire a portion of Minas's interest in the 1961 Concession. This area, comprising 650,000 hectares directly south and east of the Napo Concession, has

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3 PTX 4 (Plaintiff's Trial Exhibits are designated "PTX"; Defendants' Trial Exhibits, "DTX".)

become known as the Transfer Zone or the Coca Concession. Moore did not participate in the negotiation of this contract (the "1965 Contract"). Strouth, not Moore, signed the contract on behalf of Minas.

The 1965 Contract provided that Minas assign its interests in the Transfer Zone to Texaco del Ecuador and Gulf Ecuatoriana, or their designees, in exchange for a payment of $15,000 at the signing of the contract and a further $85,000 when the Government of Ecuador approved the transfer and for payments, when and if exploitation of oil began in the Transfer Zone, of two percent of the value of net production of all crude oil and natural gas from the area.[4]

The transferees sought approval of the assignment by the Government of Ecuador by presenting to the government a document executed by Minas along with a proposed instrument of conveyance. These two documents were designated Attachments No. 1 and 2 to the 1965 Contract. Attachment No. 1, the instrument of conveyance, recited the consideration for the transfer as $15,000. No mention is made in either attachment of the $85,000 or the two-percent payments. The 1965 Contract itself was not submitted to the Government in connection with the request for approval of the conveyance.[5]

The Government of Ecuador issued its approval of the transfer on December 20, 1965, in Resolution No. 844.

In January 1969, defendants publicly announced the first oil discovery in the Transfer Zone. Actual production began in about May 1972. In order, however, to transport the Oriente crude out to market, it was necessary to build a pipeline over the Andes mountains, down to the Pacific coast. Texaco Ecua-

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4 DTX 12A. The remainder of Minas's 1961 Concession was declared forfeit by the Government of Ecuador on February 27, 1973.

5 When in 1973 the then-Minister of Natural Resources and Energy, Jarrin, learned of the terms of the 1965 Contract, particularly the two-percent payments, he considered the contract irregular and the two-percent payments an illegal division of the resources of the sub-soil, which belonged to the State. Jarrin wanted any such payments to be declared null and void. Instead, the Government of Ecuador imposed an 86 percent tax on them. Jarrin D52-54, 61-64. (Deposition references are designated by the name of the deponent with "D" plus the page number.)

dor and Gulf Ecuador designed and built the 318 mile pipeline, the highest major pipeline in the world, at a cost of $108,000,000.

In June 1969, within seven months of the discovery of oil in the Oriente region, the Government of Ecuador required renegotiation of the concession contracts. Decree 1324, issued on June 26, 1969, significantly changed the terms of the contract regulating exploitation of the Transfer Zone and Decree 1323, those of the Napo Concession. Each concession was reduced to 500,000 hectares in size, which took 150,000 hectares from the Transfer Zone and 900,000 hectares from the Napo Concession. Defendants were permitted to select the areas to give back; however, they were not compensated by the Government for the areas relinquished or for the rights to explore for and produce crude oil in those areas. In addition, Decree 1324 raised the royalties paid to the Government on Transfer Zone oil from 6 percent to 11.5 percent.[6]

On September 27, 1971, the Government of Ecuador enacted a new hydrocarbons law (the "1971 Law"), which replaced the 1937 Petroleum Law.[7] Article 1 of the 1971 Law set out the basic concept of the Government of Ecuador, concerning the petroleum resources in Ecuador:

> The deposits of hydrocarbons and accompanying substances, in whatever physical state, located in the national territory, including the areas covered by territorial sea water, belong to the inalienable and imprescriptible patrimony of the State.[8]

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6 The Government had originally sought in January 1969 to raise the royalty to 15 percent. PTX 287. In June 1965, Crawford of Texaco stated in a memo to the Texaco Chairman, in which he was discussing the conveyance to defendants of the Transfer Zone, that he expected that the Government of Ecuador, before it approved the transfer, would insist upon renegotiation of many of the terms of the Minas Contract as it applied to the area to be acquired by Texaco. The likelihood of renegotiation appeared, therefore, to have been recognized by defendants even before the discovery of oil.

7 The 1961 Concession and the 1965 Contract had come into effect under the provisions of the 1937 Petroleum Law.

8 DTX 40B.

The 1971 Hydrocarbons Law, as originally promulgated, did not apply to contracts already in existence. It provided for much more onerous terms to be incorporated in concession contracts executed after it became effective. These provisions included a maximum concession area not to exceed 200,000 hectares, with the exploitation area not to exceed 160,000 hectares, a surface tax starting at 10 sucres a year per hectare (.40¢) and rising, after five years of exploitation to 100 sucres per hectare ($4),[9] and a government royalty of 16 percent. The new law permitted the Government to compute royalties and income taxes by a "reference price" which would be uniform for all producers. The reference price would be set by agreement with the producers or unilaterally by the Government. Factors such as the grade of the oil, the condition of Ecuadorian oil industry, world market conditions, other countries' reference prices, transportation costs, and other pertinent factors would be taken into account in setting the reference price. The 1971 Law specifically provided, however, that if the actual sales prices were ever higher than the reference price, the assessments would be calculated on the basis of the actual sales price.[10]

The 1971 Law also provided for Government participation in oil production by means of "association contracts" under which CEPE would be a party.

In February 1972, a military government took power in Ecuador. The head of the new government, General Guillermo Rodriguez Lara, appointed Navy Captain Gustavo Jarrin Ampudia to be Minister of Natural Resources and Energy. Captain Jarrin served as Minister from February 1972 until

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9 DTX 40B, Chap. V., Art. 43, 45. This compares to a surface tax under the 1961 Concession Contract starting at $4000 for the 4,350,000 hectares (less than .1¢ per hectare) and rising after eight years to $16,000 (.37¢ per hectare).

10 DTX 40B, Chap. VII, Art. 65. Under the 1961 Concession Contract, the Government royalty was computed on the world market price of a similar grade of Texas crude, plus the pipeline tariff for Texas crude to the nearest exporting port, minus the cost of transporting Ecuadorian crude from Guayaquil to the port of New York, and minus the cost, including depreciation of plants, pipelines and equipment, of transporting crude from the Oriente to Guayaquil, DTX3B, Cl. 26.

October 1974. During that time he established the oil policies of the Government of Ecuador and was responsible for implementing them.

The military government continued to adhere to the belief of its predecessors that the deposits of hydrocarbons were the inalienable and imprescriptible patrimony of the people of Ecuador. To ensure greater participation of Ecuador in the exploitation of its petroleum reserves, however, the military government turned from the predecessor Ibarra government's policy of prospective participation and enacted means to implement participation in pre-1971 Law concessions. By Supreme Decree 430,[11] issued on June 6, 1972, the military government ruled that the 1971 Law would be retroactively applied to all concession contracts entered into before that law was promulgated. All such concessionaires were required by Clause Sixth of Supreme Decree 430 to "sign new contracts, within a year counted from the enactment of this Law, of a single type, and which shall be similar for all." Supreme Decree 430 also required companies, which were in the exploitation period of their contract and which held more than the maximum concession area allowed by the 1971 Law, to return 60 percent of the area in excess of the maximum.[12] The return of acreage was to be in the shape of rectangles with a surface of no less than 20,000 hectares. Finally, Supreme Decree 430 provided in Clause Seventh that the "Minister of Natural Resources and Tourism, shall declare caducity (forfeiture) of the contract of the concessionaires . . . that would oppose either totally or partially the application of these provisions. . . ." Because of this caducity provision, defendants, who had invested some $260,000,000 in Ecuador and who were just at the production start-up point, did not challenge the legality of Supreme Decree 430.

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11 Under Ecuadorian law, a "Supreme Decree" is issued by a president who has dictatorial authority with legislative, as well as executive powers. Supreme Decrees have the characteristics of law, prevailing over all other provisions of public or private law, which they may oppose. DTX 47B, Art. 2; T-1865-1866.

12 DTX 47B, Cl. 2. Under Article 19 of the 1971 Law, the maximum acreage allowed during the exploitation period was 160,000 hectares. DTX 40B.

As required by Supreme Decree 430, defendants relinquished substantial acreage to the Government at the end of December 1972. Because the area returned had to be in rectangular blocks of 20,000 hectares, some of that acreage contained proven reserves or wells which had tested for oil. CEPE exploited the profitable portions of the relinquished area and by 1982 was producing at least 20,000 barrels of oil a day from them. The Government of Ecuador did not compensate defendants for the reserves, the rights or the future production or profits they were required to relinquish. In January 1973, defendants requested indemnification from the Government for the area that was turned back. The request was rejected. Minister Jarrin announced that:

> The return of areas to the Ecuadorian State corresponds to the application of the Hydrocarbons Law and of the Supreme Decree Number 430, which safeguard the inalienable interests of the nation. . . .
>
> [T]he Ministry of Natural Resources declares in a definite and emphatic way that it does not accept nor shall accept any request for indemnification because it is not covered by the legal provisions in force nor by the petroleum policy encouraged by the Nationalistic and Revolutionary Government of the Armed Forces.[13]

In the meantime, with commercial production of oil from the Transfer Zone imminent, questions concerning the two percent payments under the 1965 Contract needed to be resolved. First of all, in 1967 Phoenix had filed a lawsuit against Norsul in the Province of Alberta, Canada, seeking a judicial determination of Phoenix's percentage interest in the two percent payments and in Minas. In addition, between 1965 and 1971, Stroutth had filed in the courts of Ecuador a series of instruments assigning Minas's interest in the two percent payments to Petromin, S.A., and West Coast Petroleum, Inc., entities controlled by Stroutth.[14]

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13 DTX 347.

14 Moore, in a November 12, 1971, letter to Texaco, described Stroutth's activities in filing these assignments as "paper-hanging." DTX 41.

In 1971, a group of investors from Albany, Georgia, bought Norsul from Strouth for $130,000, plus four non-interest bearing notes of $55,000 each. Also, in August 1971 Phoenix settled its lawsuit against Norsul by dividing all of Norsul's assets in Ecuador, including the two percent payments, equally between Phoenix and Norsul. When the two percent payments began, Norsul and Phoenix would each receive half, or one percent.

In October 1971, C. Dixon Oxford, the new president of Norsul, and B.C. Gardner, an attorney and vice president of Norsul, contacted Texaco in order to obtain an acknowledgment of some type from Gulf and Texaco that Norsul and Phoenix were the owners of the royalty on the Transfer Zone. The Norsul representatives were told that Texaco would be willing to discuss how such problems would be worked out so as to leave a clear record regarding payment of the royalty.

A meeting was held at Texaco corporate headquarters in New York City on November 9, 1971, between Norsul, Phoenix, Gulf and Texaco to work out the title documentation which Texaco and Gulf would require before they would make the two percent payments to Phoenix and Norsul. Moore met with Texaco representatives in New York on December 15, 1971, again to determine what documentation Texaco wished to receive in connection with Minas's interests. By June 23, 1972, defen-

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Moore, in a February 19, 1973, letter to Texaco, further portrayed Strouth's activities as "the unfortunate actions of our mutual Quito nemesis." DTX 82. Moore, in his trial testimony, expanded on this description:

> What unfortunate actions were you referring to, Mr. Moore?
>
> A. Mr. Strouth was a local character who received considerable publicity by way of his dress, including a monocle and a cape, by way of his pronouncements, by way of his parties, by way of his high profile, which caused problems, if there were any problems, in the matter of his actions, yes.
>
> Q. Among the unfortunate actions of Mr. Strouth were statements he made that antagonized Government officials, particularly those in the Ministry of Natural Resources; correct?
>
> A. I wouldn't say particularly. He antagonized everybody he came in contact with. T-380.

Minister Jarrin particularly disliked and distrusted Strouth, considering him to be corrupt and to be profiting irregularly from the petroleum wealth of the State.

dants appeared to be satisfied that Phoenix and Norsul had produced adequate documentation to support their claim that they were now the owners of the two percent production payments.

Defendants also came to the conclusion that the price for calculating the two percent payments had to be renegotiated with Norsul and Phoenix. A November 22, 1972, Texaco memorandum reflected this position: that the original contract provision had been frustrated since the "government royalty", which was the basis for calculating under the 1965 Contract, had been a bilaterally established reference price and the amount of the government royalty was now unilaterally set by the Government of Ecuador. A meeting of Texaco, Gulf and Norsul representatives was held at Texaco's Coral Gables, Florida, office on November 27, 1972, to discuss this issue. An agreement to set a new basis for the two percent payment for a period extending through March 31, 1973, was reached by those present. A copy of the agreement was mailed to Moore. After much further discussion, in early 1973 an Interim Agreement was arrived at for the last two quarterly payments of 1972 and the first quarterly payment of 1973. The Interim Agreement specifically provided that the parties were not waiving any rights under the 1965 Contract. The Agreement was executed by Phoenix as of February 5, 1973, and by Norsul, Texaco and Gulf as of February 7, 1973.

Immediately after the Interim Agreement was signed, Texaco notified Phoenix and Norsul that its Quito office was being instructed to make the two percent payments for the third and fourth quarters of 1972. At this point, however, Minister Jarrin became aware of the two percent payments. On February 22, 1973, Jarrin wrote to the Minister of Finance, requesting that the two percent payments be prohibited:

> [A]s it is known that the percentages agreed upon as a kind of royalty have no legal basis whatsoever and have not yet been satisfied by those subject to the obligations, I am requesting you to take the appropriate measures to recover the revenues due the Nation and to study the means for issuing a Special Decree, which would leave without effect the percentages illegally agreed upon and to

> dispose of those funds for purposes which best serve the country.[15]

On February 23, 1973, Jarrin instructed defendants to suspend any payment of the two percent to Phoenix and Norsul.

Jarrin did not succeed in having the two percent payments cancelled or confiscated. However, the outcome was close to this result. On May 29, 1973, Decree 602 was issued, placing an 86 percent tax on all income generated by premiums, percentages or other kinds of participations given for assignments or transfers of mining or hydrocarbon concessions. The tax was retroactive to include past payments.

After the promulgation of Decree 602, Texaco Ecuador and Gulf Ecuador made the 14 percent after-tax portion of the two percent payments to Phoenix and Norsul for the third and fourth quarters of 1972 and the first quarter of 1973. The 86 percent tax was paid directly to the Development Bank, pursuant to Decree 602.

The parties agreed to extend the provision of the Interim Agreement to cover the calculation of the two percent payments for the second and third quarters of 1973. Then, in October 1973, war broke out in the Middle East and world oil prices, as well as the Ecuadorian Government reference price, began to rise dramatically. The parties could not agree on the basis for calculating the two percent payments for the fourth quarter of 1973. At the same time, a new problem appeared which further complicated the resolution of the problems with the two percent payments: the negotiation of new concession contracts, required by Supreme Decree 430.

In February 1973, the Ministry of Natural Resources had presented defendants with the draft of a new Model Contract. This proposed contract did far more than just alter the 1962 Contract to conform to the 1971 Law. It contained certain provisions which were much more onerous and which defendants found unacceptable. These included an option for CEPE to participate in Texaco Ecuador and Gulf Ecuador's operations by purchasing stock at par value. Defendants were strongly

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15 DTX 86B.

opposed to this idea because par value was extremely low. CEPE would acquire its interest for practically nothing. Furthermore, the aim of the Government of Ecuador was to achieve participation in the exploitation and marketing of Ecuador's oil resources, a goal which stock ownership in American corporations would not accomplish. Defendants feared that, as soon as the Government realized this, the Ecuadorians would turn around and force participation on the companies. Texaco Ecuador and Gulf Ecuador would then "have the worst of both worlds": the Government of Ecuador as a stockholder in the company and the Government oil company as a partner in the oil operation.[16]

Other provisions which defendants found to be particularly troublesome were a reduction in the term of the contract, an expansion of "internal consumption crude" to include crude supplied to an Ecuadorian export refinery,[17] and a reference price which was unilaterally set by the Government, without any requirement that cost or world price be considered.

Minister Jarrin was unwilling to negotiate the terms of the model contract since it was to be promulgated legislatively by decree. Defendants were able to discuss some of the proposed provisions with the Ministry. They did not, however, succeed in adjusting all the problems they foresaw. The Model Contract was published on March 27, 1973, as Decree 317. It no longer provided for CEPE to acquire stock ownership in the operating companies. Instead, it required concessionaire companies to make a future conveyance to CEPE of an undivided interest in an as yet to be determined percentage of their rights, obligations and properties. Defendants were not able to ameliorate the other troublesome provisions of the model contract.

Texaco Ecuador and Gulf Ecuador would now be required to enter into a new contract, conforming to the Model Contract, for the Transfer Zone. The only negotiation possible would be over a few blank spaces, such as the percentage and starting

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16 T-1286 (Shields).

17 "Internal consumption crude" had to be sold at a price unilaterally set by the Ministry, which was far below the market price and ultimately even below the royalty paid by defendants to the Government on such crude.

date of CEPE's participation and the beginning and termination dates of the exploitation period. The new contract would call for a 16 percent royalty which the companies were, in fact, already paying.

Texaco Ecuador summed up the new situation as follows:

> The signing of the new contract will sever our relationship with the old [1961] contract where we had basic essential protection against arbitrary Government rulings. The new contract exposes us to the rulings of the Government which could make the operation uneconomic at any time with almost no recourse. Again, this is now in the form of a law and cannot be avoided without a direct confrontation. We reluctantly conclude it must be accepted and so recommend.[18]

In June 1973, just a few months after the promulgation of the Model Contract, Ecuador became a non-voting member of the Organization of Petroleum Exporting Countries ("OPEC"). It became a voting member five months later. After joining OPEC, the Government of Ecuador considered itself obligated to comply with OPEC policy. Such policies were set out in published resolutions, which provided, for example, that OPEC member nations would endeavor as far as feasible to explore for and develop their hydrocarbon resources directly; that terms and conditions of existing concession contracts would be open to revision at predetermined intervals; that financial provisions of concession contracts which resulted in excessively high net earnings would be open to renegotiation, or if the operator declined to negotiate, excessive amounts of earnings would be estimated by the Government, OPEC Resolution XVI.90; and that all Member Countries would establish negotiations with the oil companies to achieve effective participation by the Member Countries in existing oil concessions, OPEC Resolution XXV.139.

Shortly after Ecuador joined OPEC, the Government, on August 4, 1973, published Decree 925 which set out all the terms and conditions of the new Model Contract which Texaco

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18 DTX 108.

Ecuador and Gulf Ecuador would be required to enter into, pursuant to Supreme Decree 430 (the "1973 Contract"). The 1973 Contract was signed by Texaco Ecuador and Gulf Ecuador on August 6, 1973.

Clause 52 of the 1973 Contract granted CEPE the option to acquire up to a 25 percent participation in the "rights and actions conferred in the present contract and of the assets conferred in the present contract and of the assets acquired by the contractors for the purpose of this agreement. . . ." The consideration to be paid for this participation was described as "the value of the respective rights, assets and obligations in accordance with the terms and conditions to be determined by the parties." If CEPE elected to exercise its option, "it shall give notice within 90 days prior to June 6, 1977."

The 1973 Contract, by Clause 53, replaced defendants' concession contracts, including the 1961 Contract. It also consolidated the Transfer Zone and Napo Concession areas within its coverage. It included all of the provisions of the Model Contract, which defendants found troublesome, including a tax reference price unilaterally set by the Government, reduction of the exploitation period in the Transfer Zone and an open-ended internal consumption crude requirement.

The Government of Ecuador did not pay defendants any compensation for the oil production or the right to extract oil which was lost by the shortening of the exploitation period. Minister Jarrin testified at his deposition that the Government paid nothing for the reduction in the term of the concession.

> How was the Government going to pay any amount over the wealth of the subsoil which, according to the law, is inalienable, and indescriptable [sic]? It belongs to the State. It did not have to pay anything. It did not have to pay for something that was its own property.[19]

Dr. Luis Arauz, legal adviser to Minister Jarrin, concurred in this opinion:

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19 Jarrin D-41.

> It had no reason to pay. It was a mandate of the law. It was an act of full sovereignty so that it did not pay one single cent and it had no reason to do so.[20]

Although the 1973 Contract provided for CEPE to acquire its participatory interest in June 1977, the Government of Ecuador decided to accelerate that participation. On January 2, 1974, Supreme Decree 9 was issued. This decree cited the OPEC policy of achieving government participation in the property of the oil companies and declared that Minister Jarrin would commence negotiations with Texaco Ecuador and Gulf Ecuador "for the purpose of making effective during the course of the present year, the option of participation of CEPE in the 25 percent of the rights conferred in the contract entered into for the exploration and exploitation of hydrocarbons and in the assets acquired by the contractors for purposes of said contract."

Robert Shields, who was Chairman and Chief Executive Officer of Texaco Ecuador at that time, testified at trial that, when Decree 9 came out, he did give consideration to opposing its application to Texaco Ecuador and Gulf Ecuador. He concluded that any such opposition would be "totally counterproductive."

> It would result in, at worst, caducity, and, at best, a decreed participation, probably in excess of the 25 percent, mostly [sic] in excess of 50 percent.[21]

Defendants decided that, in negotiating with the Government of Ecuador for the compensation to be paid for CEPE's 25 percent participation, they would seek payment for 25 percent of the unamortized producing and pipeline assets on the books of Texaco Ecuador and Gulf Ecuador, updated to current value, plus the right to 25 percent of production in the concession area for the period 1974 through 1977, when the CEPE option was supposed to be exercisable under the 1973 Contract.[22] Shields

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20 Arauz D-65.

21 T-1301.

22 T-1302-03.

was of the opinion that the Government would pay nothing for rights, but only for unrecovered investment.

Defendants presented their request to the Government to be compensated for unamortized assets at updated book value and for the loss of their rights to 25 percent of the crude produced from the area for the period 1974 to 1977. The Government at the outset informed defendants that CEPE would begin its 25 percent participation on June 6, 1974, whether or not there was an agreement on compensation. June 6 was the second anniversary of Supreme Decree 430, a day of patriotic significance.

Negotiations were not a dialogue. The Government told defendants that they would be compensated for the net book value or the unrecovered actual investment in producing and pipeline assets. Defendants' request to be paid for their lost rights in production for the period 1974-1977 was rejected out of hand. Minister Jarrin set out this position at his deposition:

> Q. Did the Government of Ecuador pay any compensation or consideration to the companies Texaco [Ecuador] or . . . Gulf [Ecuador] when it decided to accelerate the option for CEPE's participation by three years?
>
> A. No, sirs. No. The Government of Ecuador determined and we established this policy in general terms, that we would only pay for the investments in book value, those investments that were not yet amortized.
>
> Q. For what reason or reasons did the Government not compensate Texaco [Ecuador] and . . . Gulf [Ecuador] when it accelerated the option for CEPE's participation by three years?
>
> A. Well, a very simple reason. Because the country is the owner of its resources. All of the wealth of the subsoil according to the law, is the inalienable and inprescribable patrimony of the State and no one can—it is the patrimony of the State. This means that it can—it never prescribes, it never ends, and it cannot be alienated. I repeat once again?
>
> Q. Go ahead.
>
> A. I was saying that in accordance with the law, the resources of the subsoil, especially the hydrocarbon

> resources, are the patrimony—the inalienable and inprescriptable patrimony of the people of Ecuador. This means that it never prescribes and it can never be alienated. And if it was ever alienated, the Government may recover it at any given time. . . .
>
> If I correctly understood the question, the Government of Ecuador, when it enforced the option or put it into force the option for CEPE to enter with 25 percent as participating within the contract signed with the consortium Texaco-Gulf, it determined, as policy, that only it would pay for those investments that were not amortized yet. There was no right to be paid, nor any profit, no benefits foregone of any type. This is a resource of the subsoil that belongs to the people of Ecuador and to the Government of Ecuador, and it does not have to pay for any benefits foregone or profits in the future to anyone.[23]

Minister Jarrin, in his capacity as Minister of Natural Resources, decided exactly how much the Government would pay Texaco Ecuador and Gulf Ecuador in compensation for CEPE's acquisition of its 25 percent participation, and what it would pay for. As he testified at his deposition: "I was responsible and I implemented oil policy and I established it."[24]

The decision of the Government of Ecuador to pay Texaco Ecuador and Gulf Ecuador only for the depreciated value of their investments in the concession area, reflected the policies and practices of OPEC. According to Minister Jarrin:

> We communicated to OPEC of the problem that we had with the companies for the new oil contracts, and we requested this support because we were putting into effect new provisions that had been discussed with OPEC in connection with nationalization of the oilfields throughout the world. And, therefore, it was the OPEC policy that payment would be made only for nonamortized investments.

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23 Jarrin D-47-49.

24 Jarrin D-49.

> And we requested the support of OPEC to implement this policy in Ecuador.[25]

Dr. Arauz testified at his deposition concerning the same reasoning of the Government in determining what to pay for the acquisition by CEPE of its 25 percent participation: There was no need for discussion within the Ministry; participation would be under the same terms established by OPEC, *i.e.*, payment for the depreciated value of investments; there would be no payment for exploitation rights because the State was the owner of the wealth.[26]

> It would have been immoral and it would have been very damaging to the country if the country owns the deposit, the oil. And why is it going to pay for the exploitation of its own wealth.[27]
>
> Q. Dr. Arauz, did the Government of Ecuador pay Texaco [Ecuador] and . . . Gulf [Ecuador] for 25 percent of their investment in Ecuador when CEPE obtained a 25 percent participation?
>
> A. The Government of Ecuador paid 25 percent of the investments which are listed in Clause 3 of the Acta.
>
> Q. Now, subsequent to the effective date of the participation, CEPE received 25 percent of the oil produced in the 1973 contract area; is that correct?
>
> A. Yes. This appears in the Acta and this was a fact.
>
> Q. Did the Government of Ecuador buy from Texaco [Ecuador] . . . Gulf [Ecuador], the right to receive such oil?
>
> A. The Government of Ecuador and CEPE did not acquire the right because they already had it. The State was the owner. What it paid for was the investments made under the terms which appear in the Acta.
>
> Q. Did the Government of Ecuador buy from Texaco [Ecuador] and . . . Gulf [Ecuador] the right to receive possible profits on oil from the 1973 contract area?

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25 Jarrin D-57.

26 Arauz D-73-77.

27 Arauz D-76-77.

> [Objection omitted]
> A. Ecuador did not acquire or buy this right to have profits. What it bought was what appears in the Acta, the assets.[28]

Robert Shields of Texaco Ecuador, who took part in the discussions with the Ministry about the price CEPE would pay, found that the subject of production rights or interests in the oil reserves could not even be mentioned in the meetings with the Ministry.

> They wouldn't even talk to us about what the oil reserves were or the future profits, anything like that. You couldn't even get a conversation. That shut it up and started a tirade if you brought it up.[29]

On June 14, 1974, the Minister, the General Manager of CEPE, and the managers of Texaco Ecuador and Gulf Ecuador signed an Acta (minutes) which set out the terms of CEPE's 25 percent participation in the "rights and assets of the Consortium Texas-Gulf." The price paid by CEPE was to be determined by investments and costs of equipment and materials, from which would be deducted amortization and depreciation. The exact amount of this price was to be established by an independent audit.[30]

The international accounting firm of Peat, Marwick, Mitchell & Co. ("PMM") was selected by CEPE to perform the audit. On July 5, 1976, PMM presented its final report, concluding that, as of June 6, 1974, the book value or cost of

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28 Arauz D-263-65.

29 T-1566-67.

30 DTX-201. On May 22, 1975, Resolution 12560 established the conditions for the audit. Despite the provision in the June 14, 1974 Acta that the Government would pay for 25 percent of the unrecovered investment in the pipeline, Resolution 12560 provided that CEPE would not acquire an interest in the pipeline and pipeline assets were to be excluded from the audit.

Texaco Ecuador and Gulf Ecuador's producing assets, less depreciation and amortization, and the book value or cost of their materials and supplies inventory was in the total amount of approximately $182,000,000.

The Central Bank of Ecuador paid Texaco Ecuador and Gulf Ecuador 25 percent of this amount, or $45,033,671, as follows:

Date	*Payment to Texaco Ecuador*	*Payment to Gulf Ecuador*
July 1974	$12,500,000	$12,500,000
October 1974	5,000,000	5,000,000
January 1975	2,500,000	2,500,000
June 1975	1,411,397	1,411,397
January 1978	1,002,399	—
April 1979	—	1,208,478

The total paid to Texaco Ecuador and Gulf Ecuador did not include any interest, despite the fact that payments were made over a period of almost five years.

None of the assets, materials and supplies had been paid for by Phoenix or Norsul and no part of the payments received by defendants for CEPE's participation was passed on to Phoenix or Norsul.

Three days before the June 6, 1974, acquisition by CEPE of its 25 percent share, Resolution 11927 was issued to clarify the basis for the calculation of the two percent payments to Phoenix and Norsul, and consequently of the 86 percent tax. The Resolution added an additional requirement: that henceforth one half of the 14 percent payments be retained for investment in Ecuador. Because the CEPE participation was imminent, Resolution 11927 also dealt with the impact on the two percent payments of CEPE's obtaining a 25 percent interest in the Texaco-Gulf consortium. Article 6 of Resolution 11927 provided that, as of the date of CEPE's participation, "there shall be excluded, in order to carry out the assessment of the 2% the percentage of CEPE in the net production. . . ." It was upon this language that the Court in *Phoenix II* based its decision that defendants did not breach the 1965 Contract when they

stopped making two percent payments on the value of CEPE's share.[31]

Texaco Ecuador and Gulf Ecuador reduced the two percent payments to Phoenix and Norsul by the 25 percent of CEPE's participation as of June 6, 1974.

Resolution 11927 was challenged by Texaco Ecuador and as a result was affirmed by a Ministerial Sentencia (Judgment), issued on October 2, 1974. The Sentencia further provided in Clause 3 that the exclusion of CEPE's participation from the calculation of the two percent payment would be "valid for any increase which may be obtained in this respect." Neither Phoenix nor Norsul made any appeal to the Government of Ecuador in regard to the provisions of Resolution 11927 and the Sentencia or to the reduction of the two percent payments.

Other aspects of defendants' relationship with the Government of Ecuador became increasingly troublesome during 1974, 1975 and 1976. One problem was overretainage of incautation deposits. The oil companies were required to deposit with the Central Bank all proceeds of their export sales of crude oil, or an amount equal to its tax reference value, whichever was greater. From these deposits, the Government would deduct the

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31 That Phoenix and Norsul were also of the opinion that Resolution 11927 terminated the two percent payments on CEPE's share can be seen from the April 15, 1975, letter of the Ecuadorian lawyer for Norsul (and Phoenix), Andres F. Cordova, to the then-Minister of Natural Resources, Admiral Salazar. This letter was not listed as an exhibit in the Pretrial Order. However, plaintiff moved its admission at trial as PTX 281. The translation of the letter into English is poor. The basic purposes of the letter were two: first, to request the release of a part of the seven percent of the two percent payments, which Resolution 11927 required Norsul and Phoenix to invest in Ecuador, in order that it would be used for preliminary studies and office expenses; and second, to persuade the Minister not to hold Norsul and Phoenix responsible for the outstanding debts of Minas. The letter also mentioned in passing that Resolution 11927 required that, in computing the two percent payments, the value of the CEPE participation first be subtracted. Dr. Cordova noted that this was a serious legal error, which injured Norsul's interests. The letter went on to state that, although Norsul considered this to be neither legal nor just, it had preferred not to raise this issue with the Government.

Dr. Cordova did succeed in his efforts to release investment funds and to free Norsul and Phoenix from responsibility for Minas's debts.

taxes and royalties due it and return the rest to the companies. The Central Bank failed to calculate correctly the amounts due to the Government and retained amounts which belonged to the oil companies. By 1976, the Government had overretained $22,000,000 of the monies due to defendants.

Internal consumption crude also was a problem. The oil companies were required to pay a royalty to the Government on internal consumption crude, based on the tax reference price. By October 1974, the royalty which defendants had to pay on each barrel was $2.22. However, the Government had unilaterally set the price it would pay for the purchase of each barrel of internal consumption crude at $1.48. Consequently, the companies actually lost money on each barrel of internal consumption crude that was sold. In addition, some of this crude was being delivered to national refineries and then exported by the Government for profit.

Between October 1974 and October 1975 the Ecuadorian income tax rate rose from 45 percent to 71.5 percent. The Government royalty on oil had also risen from six percent in 1969 to 16 percent. In November 1975, it was again increased, up to 17 percent.

The Government began restricting the amount of oil which the oil companies could produce. Then in April 1975, the Government decreed that CEPE's 25 percent participation would be based not on actual production but on a "presumed" production figure. The presumed production of 210,000 barrels a day was not only greater than actual production, it was greater than the maximum volume which the Government permitted Texaco Ecuador and Gulf Ecuador to produce. Defendants were not in any way compensated for this maneuver which was in effect an increase in the percentage of CEPE's participation.

Moreover, CEPE was habitually late in meeting its 25 percent share of operating expenses and its payments for internal consumption crude.

In December 1975, the Government unilaterally set a presumptive production cost which was used to calculate Texaco Ecuador and Gulf Ecuador's income taxes. Actual costs were, in fact, higher than the "presumptive costs."

CEPE also began lifting crude oil which was not part of its 25 percent share, without compensating Texaco Ecuador and Gulf Ecuador for taking part of their share. The Government then demanded that the companies deliver an additional two million barrels to CEPE, without compensation, which it claimed was due to CEPE under "presumed" production figures.

Defendants had attempted without success to discuss their problems with the Rodriguez Lara government and with the military junta which replaced it in January 1976. Under the military junta, Col. Rene Vargas Pazzos, General Manager of CEPE, was appointed Minister of Natural Resources and Energy. Texaco Ecuador and Gulf Ecuador regarded Minister Vargas as an ideologue with nationalist, anti-capitalist, and anti-oil company views.

From the outset, Minister Vargas declared to Gulf Ecuador that it had no right to question the actions of the Government. Vargas and his deputy, Carlos Jaramillo, threatened Gulf Ecuador with nationalization of its interests. Terence O'Brien, who was President and General Manager of Gulf Ecuador, testified that the actions of the Government had brought about a de facto nationalization of Gulf Ecuador's rights without compensation. This continual erosion of Gulf Ecuador's position worsened in June 1976 with CEPE's lifting of crude which belonged to Texaco Ecuador and Gulf Ecuador. Both companies protested. Gulf Ecuador went farther and in July 1976, it filed suit in the U.S. District Court in California against Atlantic Richfield, claiming that Atlantic Richfield, the refiner which had purchased the oil in question, had wrongfully converted Gulf Ecuador's property. Because of this litigation CEPE was not paid for this shipment of oil by the broker who had arranged for its purchase by Atlantic Richfield. This situation further eroded Gulf Ecuador's relations with CEPE and the Ministry.

By mid-June 1976, Gulf Ecuador decided its only hope for relief was to place its incautation deposits in an interest bearing escrow account. Gulf Ecuador planned ultimately to turn these monies over to the Government when its problems were resolved. The amount of incautation deposits withheld was approximately equal to the overretainages of Gulf Ecuador's funds by the Government. In the event of the threatened

nationalization, Gulf Ecuador felt that at least it would have saved the overretained taxes.

The reaction of the Minister, when he learned of the withheld incautation deposits, was to inform Gulf Ecuador that unless the withheld deposits were released by the end of August, Gulf Ecuador would be caduced.

Gulf Ecuador met with the military junta in mid-August to attempt to work out a compromise. The Junta added a new requirement, that Gulf Ecuador begin making incautation deposits not when it was paid for the crude, which was customary, but at an earlier point, when the crude was loaded for export. Gulf Ecuador did begin to make immediate incautation deposits for its liftings of crude but it held on to the escrowed deposits.

Gulf Ecuador, facing caducity, decided to attempt to negotiate a withdrawal from Ecuador. On August 31, 1970, O'Brien delivered a letter to the Junta, requesting such negotiations. The next day, the Government delivered a formal notice that Gulf Ecuador would be caduced unless it deposited all funds owed within 30 days. Gulf Ecuador asked for help from the American Ambassador. With the intervention of the Ambassador, Gulf Ecuador obtained the agreement of the Government to reimburse it for the company's assets at net book value. An Inter-Institutional Commission was appointed to decide the terms on which Gulf Ecuador's interests would be terminated. At the third meeting of the Commission, Gulf Ecuador was informed that, whether or not an agreement had been reached, CEPE would begin lifting Gulf Ecuador's share of crude on January 1, 1977.

In the closing hours of 1976, the Government and Gulf Ecuador reached an agreement in principle by which CEPE acquired Gulf Ecuador's remaining 37.5 percent interest. The agreement provided for Gulf Ecuador to transfer its assets to the Government and for the Government to pay for these assets at net book value, or unrecovered actual cost. The Agreement described the subject of the sale and the price as follows:

> 2.1 By the present agreement Gulf [Ecuador] transfers in perpetuity in favor of CEPE the totality of its rights in

> the assets that correspond to it in the present CEPE/TEXACO/GULF consortium and those that correspond to it in the Trans-Ecuadorian Pipeline. Accordingly, as of December 1976, at 06:00 hours the contract for exploration and exploitation of hydrocarbons entered into on 6 August 1973, authorized by Decree No. 925 of 4 August 1973, is extinguished as to Gulf [Ecuador] by reason of transfer.
>
> 2.2 For the transfer established in the preceding paragraph of this clause the Government of Ecuador via CEPE, shall pay to Gulf [Ecuador] the percentage that corresponds to it in the amount of the investments not amortized made in the performance of the contract of 6 August 1973 and those preceding, in accordance with justifying documents for the investments and the respective physical inventory and, also the cost of equipment, materials and supplies in stock and in transit. . . .
>
> 2.3 To establish the values corresponding to the investments mentioned in the preceding number, the amounts for amortization and depreciation taken up to December 31, 1976 shall be deducted.

Clause 2.4 provided that an independent European auditing firm would be selected to establish the value of assets.

Gulf Ecuador insisted on a "quitclaim" as a term of the agreement. O'Brien testified that this was to make sure that Gulf Ecuador would not be required to face future claims that hadn't been addressed in the agreement. One such possibility was a demand, being talked about by leftist university students, that Gulf Ecuador pay for reservoir damage.[32] Clause 2.16 provided that "apart from the rights and obligations established in the present agreement, neither the Ecuadorian State nor CEPE owe anything to the Ecuadorian State or to CEPE."

The Government also then required a quitclaim, which appeared in Clause 2.13. According to Terence O'Brien, Clause 2.13 was supposed to protect the Government from contract

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32 T-1643

payments which were owed by Gulf Ecuador but which had not yet been entered into Gulf Ecuador's books:

> 2.13 With respect to the obligations that Gulf [Ecuador] may have in favor of third parties and that do not appear in its accounting records, neither the Ecuadorian State nor CEPE assume any responsibility and must be taken care of by Gulf [Ecuador]. Therefore, CEPE only assumes obligations in accordance with the present agreement.[33]

As of the end of 1976, with the execution of the agreement in principle, Gulf Ecuador terminated its interest in the Transfer Zone and stopped making payments to Norsul and Phoenix. CEPE did not assume responsibility for any part of these payments.

A formal agreement between the Government and Gulf Ecuador was finalized on May 27, 1977 (the "1977 Transfer Agreement"). The 1977 Transfer Agreement tracked the language of the agreement in principle which we have quoted above.

The 1977 Transfer Agreement contained an additional Clause Fourth which included a passage from a letter written by Terence O'Brien to the Minister of Finance: "[W]e clarify that . . . Gulf [Ecuador] shall not transfer to CEPE its liabilities, including its debts to third parties." O'Brien testified that he wrote the letter at the urgent request of the Minister of Finance, that the Minister gave him no reason for the request and that he, O'Brien, was not referring in the letter to the two percent payments in any way.[34]

On September 14, 1978, the accounting firm of Deloitte, Haskins and Sells ("DHS") was selected to perform the audit

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33 Plaintiff argues that the two percent payments do not appear in Gulf Ecuador's books since Gulf Ecuador could not deduct these payments as production costs for Ecuadorian tax purposes and that, therefore, liability for these payments remained with Gulf Ecuador. The fallacy of the argument that these payments did not appear in Gulf Ecuador's accounting books can be seen from the DHS audit, *e.g.*, Impugnation 11.18.

34 T-1648-49.

to "determine the definitive value . . . of the rights and shares of [Gulf Ecuador] in the assets of the Consortium CEPE-Texaco-Gulf and in the Pipeline."[35]

DHS issued its final report on April 17, 1979. It concluded that the net book value or the unrecovered actual cost of Gulf Ecuador's remaining investment in producing assets and materials and supplies inventory in Ecuador, as of December 31, 1976, after deducting depreciation and amortization as of that date, was $74,792,625; that the cost of Gulf Ecuador's investment in the Pipeline, after deducting depreciation and amortization, was $42,020,000; and that the Government of Ecuador still owed Gulf Ecuador the sum of $1,208,478 from the 1974 transfer to CEPE.

After DHS had concluded its audit, but before it issued its final report, the Ministry of Natural Resources sent to DHS "impugnations," questioning prior audit reports of Arthur Young & Company ("AY") and PMM. One of the impugnations concerned the two percent payments by Gulf Ecuador on production from the Transfer Zone. Since this item did not appear in the "State of Production Costs and Cost per Barrel Produced" of the AY final report, the Ministry believed it had been capitalized and included as investment. DHS concluded from its review of the joint Texaco Ecuador/Gulf Ecuador books and the entries relating to the two percent payments in those books that these payments were not capitalized in any of the accounts included in net investment. DHS determined that, because the two percent payments were not capitalized, they did not affect "net investment" upon which the price that CEPE paid was based. The same challenge by the Ministry and resolution by DHS was made concerning the handling of the two percent payments in the PMM audit.

The Government of Ecuador made two payments to Gulf Ecuador of the balance owing for the acquisition of its interests, one payment on May 27, 1977, and the second on April 25, 1979. Gulf Ecuador paid no part of these monies to Phoenix or Norsul.

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35 DTX 314B.

On the basis of the facts found above, and with the benefit of our observations of the various witnesses and our conclusions as to their credibility, the Court finds further that the Government of Ecuador, in acquiring the interests of Gulf Ecuador and Texaco Ecuador in the Transfer Zone, did not pay any amount for production rights or lost future profits. In both the 1974 and the 1977 transfers, the Government intended only to pay Texaco Ecuador and Gulf Ecuador for the depreciated and amortized book value of their assets, plus the book value of their material and supplies inventory. It was contrary to the political philosophy of the Government of Ecuador in 1974 and in 1977 to pay for the oil reserves, which were the property of the State, the rights to exploit those reserves, or the future profits that might be earned from those reserves.

Furthermore, we find strong support for this conclusion in the fact that the price paid matched exactly the net book value of those assets acquired; that the acceleration of the acquisition of CEPE's 25 percent participation from 1977 to 1974 did not result in any payment to defendants for the loss of exploitation rights during those three years; and that defendants never received any compensation for the loss of profits and production rights from the Government of Ecuador in connection with other reductions in the size of the concession area or in the length of the exploitation period. We also note from the Impugnation to the DHS Audit that the hostility of the Ministry to the concept of paying for past two percent payments to Phoenix and Norsul, if those payments had been capitalized, reflects a similar hostility on the part of the Ministry to paying for future rights to such payments. In addition, there was never any study made by the parties, in connection with either the 1974 or the 1977 transfer, as to what was the value of petroleum reserves in the ground or of profits that might be earned from them. Finally, the Sentencia, affirming Resolution 11927, declared the intent of the Government that any future expansion of CEPE's interests be reflected by a corresponding reduction in the calculation base for the two percent payments.

CONCLUSIONS OF LAW

I. UNJUST ENRICHMENT.

Because we have found as a matter of fact that Texaco Ecuador and Gulf Ecuador were not compensated for production rights or loss of profits resulting from the conveyance to CEPE of their interests in the Transfer Zone, we find as a matter of law that plaintiff cannot succeed in its claim based on unjust enrichment under Ecuadorian law. Defendants were not enriched because the payments they received were compensation only for the net book value of their assets. The payments CEPE made to acquire its participation were not intended to and did not, in fact, compensate defendants for any future production rights or profits. Defendants were not enriched since they were compensated only for what CEPE obtained: their assets at net book value. Plaintiff suffered no loss because defendants did not receive or retain any benefit to which plaintiff was entitled. Failing to prove either of these two essential elements of an action *de in rem verso*, plaintiff cannot prevail in its claim for unjust enrichment.

We note moreover that, even if plaintiff had proved the elements of an action *de in rem verso*, still plaintiff has not proved damages. Plaintiff has acknowledged that part of the compensation received by Texaco Ecuador and Gulf Ecuador was for assets or investment in Ecuador. However, plaintiff never designated at trial what portion of the compensation received by defendants, according to plaintiff's theories, was for defendants' investments and what portion was for loss of profits or production rights. Without this allocation, plaintiff fails to meet its burden of proof. For this reason, even if plaintiff had demonstrated the right to recover for unjust enrichment, it could not prevail here because it has failed to prove damages.

II. BREACH OF CONTRACT CLAIM.

Turning to plaintiff's breach of contract claim, the surviving part of that claim is that defendants Texaco Ecuador and Gulf Ecuador incorrectly calculated the two percent payments for three quarterly periods beginning on October 1, 1973 and end-

ing on June 2, 1974. Plaintiff contends that defendants improperly used the West Texas sour crude oil price instead of the higher Ecuadorian government tax reference price to calculate the payments for the disputed quarters. Defendants, on the other hand, contend the payments were correctly calculated because the 1961 Concession Contract specifically provided for the use of the West Texas sour crude oil price.

A. *Basis for Calculation of the Two Percent Payments.*

The 1961 Concession Contract between the Government of Ecuador and Minas incorporated Article 27 of the 1937 Hydrocarbons Law and established a formula for determining the price of oil for royalty payments to the government. Article 27 of the 1937 Hydrocarbons Law based the price of oil on the average price in the world market. Article 26 of the 1961 Concession Contract stated:

> In accordance with letter A of Article 27 of the Petroleum Law, the parties agree that if the Government decides to collect in money, the royalty provided in clause 23rd of this contract, the value of the oil for this purpose, shall be periodically established by agreement between the Government and the concessionaire, thus: *the average value of the oil in the world market*, in the preceding quarter (this value represented by letter X), shall be determined applying the following formula: X = A-B.
>
> A.—Letter A shall represent *the price posted or declared in an oil field of substantial production in the state of Texas . . . for crude oil . . .* plus the pipeline tariff established for the transportation of such crude oil from the producing field to the nearest export point.
>
> B.—Letter B shall represent the cost of transportation of the crude oil from Guayaquil to the port of New York. (Emphasis added).

A part of the 1961 Concession grant to Minas was transferred to the defendants pursuant to the 1965 Contract. Clause 6 of the 1965 Contract requires that defendants pay to the transferor "an amount which represents the value . . . of 2% of the net

production" of all crude oil and natural gas produced in the Transfer Zone. Clause 6(b) states that the value of the crude oil:

> [S]hall be understood as the value defined in each case for the purpose of calculating the payment of the royalties which cessionaires must make to the Government.

Clause 8 of the 1965 Contract further provides that it is the intention of the parties to calculate the two percent payments on the "same bases established for the respective payments to the Government according to the contract." The 1965 Contract defines such a reference to "the contract" as being to the 1961 Concession Contract.

Thus, the 1965 Contract made it clear that the two percent payments were to be calculated in the same manner as royalty payments to the Government would be computed under the 1961 Contract. The 1937 Law, which controlled these payments to the Government under the 1961 contract, specified that the price of oil would be based on the market price. The language of the 1937 Hydrocarbons Law together with the statement in the 1961 Contract that the desired price will be "the average value of the oil in the world market," gave an indication that the parties to the 1961 Contract intended to use the West Texas sour crude oil price only as a marker to arrive at the actual market price.[36]

In 1971 a new Hydrocarbons Law was enacted to replace the 1937 law. Article 65 of the new law replaced the government royalty valuation provisions of Article 27 of the 1937 law. Article 65 provided that:

> Royalties in cash, income tax, Government's participation and generally any assessments depending on the sale price of hydrocarbons in the foreign market, *shall be regulated by the reference prices of petroleum.* (Emphasis added).

Article 65 also stated that, although these reference prices might be discussed with the producers, the price would be unilaterally set by the government.

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36 The West Texas price was reflective of world market price at the time of the 1961 Contract.

No oil was produced in the Transfer Zone until 1972. Therefore, the 1937 method of valuation was never applied to set Government royalty payments on petroleum produced there; nor were the two percent payments ever calculated prior to the enactment of the 1971 Law.

Defendants contend that the effects of the 1971 Law so frustrated the purpose of the 1965 Contract that the defendants were not obligated to make the two percent payments based on the new tax reference price. They urge that a tax reference price, unilaterally established by the Government of Ecuador, cannot be used to replace the former bilaterally set royalty price, based on the West Texas sour crude marker.

When the new tax reference price went into effect, defendants decided that a new agreement was necessary. Norsul and Phoenix reluctantly agreed to enter into an Interim Agreement which established a new price valuation method. This agreement specifically provided that the parties were not waiving any rights under the 1965 Contract. The Interim Agreement covered the period from the commencement of production in the Transfer Zone in 1972 until March 31, 1973. Defendants made payments to Phoenix and Norsul in accordance with this agreement, not only through the first quarter of 1973 when, by its own terms, the agreement was terminated, but for the second and third quarters of 1973 as well. The Interim Agreement was voluntarily followed until war in the Middle East broke out in October 1973 and world oil prices and the Ecuadorian reference price skyrocketed. At the same time, the U.S. government imposed federal price controls on the West Texas sour crude oil, creating a drastic difference in price between the West Texas and world market prices.

This turn of events naturally made the West Texas price much more desirable as a marker to defendants than the tax reference price set by the government. Defendants subsequently paid Phoenix its portion of the two percent for the last quarter of 1973 and the first two quarters of 1974 calculated on the basis of the West Texas price.

It is not surprising that defendants began searching for an alternative when the price of oil and their obligations for the government royalty, and consequently to Phoenix and Norsul,

climbed so radically in such a short period of time. However, this does not permit defendants to disregard the language of the 1965 Contract and the effects on it of the 1971 Law. The 1965 Contract adopts the Government royalty, as determined under the 1961 Contract. Once the 1971 Law was promulgated, calculation of government royalties under the 1961 Concession Contract was based no longer on Article 26 of the 1961 Contract, but on Article 65 of the 1971 Law. Defendants, pursuant to the 1965 Contract, paid their government royalty on oil, produced in the Transfer Zone, on the basis of the 1971 Law. It only follows that the two percent payments, based on the two percent of the royalty paid to the Government, should in the same way be computed on the basis of the royalty actually paid, not the royalty as it would have been calculated under an enactment which was no longer in effect. For this reason, the Court now concludes that it is the official government tax reference price, and not the West Texas sour crude or any other privately negotiated price, which should be used by Texaco Ecuador and Gulf Ecuador under the 1965 Contract, to calculate the two percent payments for the disputed quarters.

Defendants argue, however, that the propriety of their use of the West Texas price is confirmed by Resolution 11927, which was drawn up to settle the disagreements over the assessment of the two percent payments. Resolution 11927 provided that the tax reference price was to be used to calculate the two percent payments from June 3, 1974, and that the 86 percent tax on the payments would be recalculated retroactively, using the 1971 Law tax reference price. The relevant provisions of the resolution stated:

> Art. 10—The Central Bank of Ecuador, with the participation of the representatives of the General Hydrocarbons Office and the National Development Bank will proceed to audit the assessments of the payment of the two percent made *prior* to issuing the present Regulation and *shall carry out reassessments corresponding to the 86 percent* of the National Development Bank.
>
> Art. 11—Provisions of the present Regulation, *insofar as they refer to the 14%* of the successors in rights of the

> grantees, shall be applied *from the present date* without prejudice to publication in the Official Registry. (Emphasis added).

This language indicates that Resolution 11927 did not address the issue of the 14 percent payments made prior to June 3, 1974, the date the resolution was issued. Minister Jarrin testified in his deposition that the fundamental purpose of the resolution was to ensure that the Development Bank was paid the correct amount of taxes on the two percent. The Development Bank needed a "clear basis" to establish the payment of the 86 percent tax. However, the private dispute over the computation of the 14 percent did not concern the Minister prior to the promulgation of 11927. Prospective calculation of the 14 percent was, on the other hand, of interest to the Government because 11927 created an obligation on the part of Norsul and Phoenix to invest one-half of their 14 percent in national development programs in Ecuador.[37] Dr. Luis Arauz, Minister Jarrin's legal advisor, also testified at his deposition that the Government was not interested in how payment had been agreed to between private parties:

> [T]his was a private contract and we could not interfere . . .
>
> This was something that had already been consummated, it was paid, and how much was paid, and how it was paid, I think we, as the Government, we would not have interfered in these very strictly private matters.[38]

Since Resolution 11927 did not effect the rights of the parties regarding the after tax 14 percent of the two percent until June 3, 1974, the payments for the previous quarters are controlled strictly by the contractual relationship between the parties. This contract incorporated the price of West Texas sour crude as an example, not as a requirement. As we point out above, the language of the 1965 Contract requires the two percent payment to be calculated on the basis of the royalty paid to the Govern-

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37 Jarrin D-92-94.

38 Arauz D-182-183.

ment, which, after the enactment of the 1971 Law, was the tax reference price.

Moreover, the fact that the Government of Ecuador refused to recompute the 14 percent for the periods prior to June 3, 1974, does not mean it adopted defendants' method of computation. It is more reasonable to conclude that this hands off attitude merely reflects the reluctance of the Government to get involved in that portion of the dispute in which it had no direct interest.

B. *Volume and Exchange Deductions.*

Plaintiff's contention that Texaco Ecuador and Gulf Ecuador have applied certain deductions to the volume base of the two percent payments which were not permitted by the 1965 Contract also has merit. Defendants deducted a 10 percent increase in the government royalty and a two percent currency exchange charge from the amount paid to plaintiff for the three disputed quarters.

The 10 percent volume reduction was imposed by defendants in order to offset the increase in government royalty from six percent at the time of the 1965 Contract to 16 percent in late 1973. This reduction was not authorized anywhere in the 1965 Contract, but defendants claim it is justified by "force majeure". "Force majeure" is defined in the Civil Code of Ecuador as an "act of God, the unforeseen which is not possible to avoid, such as a shipwreck, an earthquake, an imprisonment by enemies, acts of authority carried out by a public functionary, etc." Code Civil art. 30 (Ec.). The burden of proving an act of God is on the party who alleges it. Code Civil art. 1590 (Ec.).

The defendants have not met this burden as there has been very little if any showing that the 6 percent to 16 percent increase was unforeseen or impossible to avoid. It is true that there is ample evidence in the record of the drastic effect that the changing political climate had on the oil industry in Ecuador. However, there was no evidence that this specific 10 percent increase over a seven year period should not have been anticipated. An increase from the six percent specified in the

1961 Concession Contract could not have been completely unexpected in 1965 when other countries in the world where Texaco and Gulf were operating had higher royalties. Moreover, it was certainly possible to avoid the consequences of such an increase by providing for it in the contract.

Texaco Ecuador and Gulf Ecuador claim the same "force majeure" defense with regard to the two percent currency exchange charge. Defendants have again failed to meet their burden of proof as the possibility of a currency exchange charge can hardly be considered unforeseeable in this type of transaction.

C. Contract Damages.

We have found that defendants Texaco Ecuador and Gulf Ecuador have breached their contract with plaintiff by incorrectly calculating the two percent payments for the three disputed quarters. The parties have stipulated that the amounts paid to plaintiff for those three quarters are as follows:

4th Quarter 1973	$ 45,962
1st Quarter 1974	$ 49,157
2nd Quarter 1974	$109,047
TOTAL	$204,166

The parties have also stipulated that, if the 14 percent payments were based on the tax reference price and the additional 10 percent and two percent deductions were not taken out, the plaintiff would be entitled to contract damages in the amount of $365,479. We find that plaintiff is entitled to recover this amount.

Finally, plaintiff for the first time in its post-trial briefing asserts a claim for consequential damages, including attorneys' fees, based on alleged bad faith by defendants' in their breaching of the 1965 Contract. This claim was not included in the Pre-Trial Order and we will not permit it to be raised now in this untimely manner.

III. PREJUDGMENT INTEREST.

Phoenix contends it is entitled to prejudgment interest for the breach of contract claims from the date this action was commenced on November 26, 1976. A letter opinion by plaintiff's Ecuadorian law expert, Dr. René Bustamante, serves as the basis for Phoenix's assertions that Ecuadorian law entitles them to prejudgment interest. No other evidence of Ecuadorian law was offered by Phoenix, but the text of Monetary Board Regulation 755 and several sections of the Civil Code submitted by defendant help to clarify some of the statements made in Dr. Bustamante's letter.[39] Defendants also submitted the affidavit of their Ecuadorian expert, Dr. Miguel Andrade Varea, to counter the assertions of Dr. Bustamante.

The initial question of whether prejudgment interest is appropriate for defendant's breach of contract claim does not appear to be in dispute. Defendant's main contention, through its briefing and the Andrade affidavit, is that prejudgment interest is not permitted for the claim of unjust enrichment because the amount of the claim is not fixed until a judgment has been rendered by the court. Dr. Bustamante's letter does not address this issue of whether a definite or sum certain is required with respect to either the breach of contract or the unjust enrichment claims. However, defendant's expert does not contend that the amount due under the breach of contract claims are too uncertain under Ecuadorian law to be subject to prejudgment interest. Dr. Andrade simply concludes that "[p]rejudgment interest in Ecuador is unavailable on the plaintiff's claim for unjust enrichment." Therefore, this Court can only conclude that, to the extent certainty in the amount due is required under Ecuadorian law, that requirement has been satisfied with respect to plaintiff's breach of contract claim, and prejudgment interest is applicable.

Having determined that defendants are liable for prejudgment interest, we must decide at what date the interest begins to

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39 These submissions by the defendant included: Articles 7 and 1611 of the Civil Code of Ecuador, Monetary Board Resolution 755, and Articles 25 and 28 of the Tax Code of Ecuador.

accrue and what rate of interest to apply. The dispute over the date at which interest begins to accrue centers on whether the date of filing the complaint or the date of service of the complaint is controlling. The complaint was filed on November 26, 1976 and served on Gulf Ecuador on December 1, 1976 and on Texaco Ecuador on December 3, 1976.[40]

Defendant's expert, Dr. Andrade, states in his affidavit that if prejudgment interest were to be assessed it would begin to accrue only from the dates the complaint was served on the defendants. Andrade does not refer specifically to the basis for his conclusion. However, it is consistent with the principle that prejudgment interest cannot attach until the debtor is made aware of a definite sum which is due. Plaintiff disputes Dr. Andrade's conclusion but offers no support for its position. Dr. Bustamante's letter does not make any reference at all to a date when prejudgment interest should accrue, nor does he refer to whether the claim must be certain before prejudgment interest can attach. Since there is no evidence in the record to oppose defendant's position, we find that prejudgment interest shall accrue from the date of service.

The parties have not contractually stipulated to any particular rate of interest or formula to compute the interest. Where the rate has not been stipulated by the parties, both experts agree that the legal rate of interest applies. The legal rate of interest in effect in Ecuador at the time the complaint was filed and served was eight percent per annum. Monetary Board Resolution 755, January 16, 1975. Defendants contend that this eight percent interest rate should be applied from the date of accrual to the present. Plaintiff, on the other hand, argues that the legal rate of interest increased five different times since Regulation 755 went into effect in 1975, and that the rate of prejudgment interest should increase as well during those periods. The last change went into effect on December 20, 1984 and

40 Although the length of time between the dates is not great, the controlling date must be determined in order to properly measure the amount of prejudgment interest due.

increased the legal interest rate to 23 percent.[41] Therefore, the difference in rates asserted by plaintiff and defendant is dramatic.

Dr. Bustamante's letter consists of a somewhat detailed analysis of the rates of interest in the Ecuadorian legal system. Dr. Andrade simply makes a conclusory statement that the rate of interest is to be calculated at a rate of 8 percent from the time the complaint was served. However, Dr. Andrade cites and includes as exhibits to his affidavit Article 7 of the Civil Code and a judicial opinion of the Supreme Court of Justice of Ecuador. *Segoria v. Acosta*, Judgment No. 341, Third Chamber, November 11, 1977. Article 7 of the Civil Code establishes the general principle that a new law shall prevail over a previous law where provisions in the two laws conflict. This provision obviously favors plaintiff's position that the rate of interest should increase with the legal rate.

In the *Segoria* case, a legal rate of 6 percent, the rate in effect at the time the complaint in *Segoria* was served, was applied for the entire period even though Resolution 755 changed the rate of 8 percent two years before the decision was rendered by the Court. The Court based its decision upon language in Article 8 of Regulation 755 which states that the provisions of the "Regulation shall apply only to the acts and contracts entered into from and including the date it is published in the *Registro Oficial*." *Segoria* at 11; Regulation 755, Article 8. However, there are two problems with this analysis which cast doubt on defendants' position. First, judicial decisions are not binding precedent in a civil law jurisdiction such as Ecuador. *Phoenix III* at 10 n. 11 [Available on WESTLAW, DCT database]. Second,

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41 Increases in the legal interest rate in Ecuador as set forth by Dr. Bustamante in his letter opinion of June 11, 1985, were as follows:

1975 Regulation 755, January 25, 1975, 8%
1982 Regulation 1170, January 11, 1982, 15%
1983 Regulation 061, March 19, 1983, 16%
1983 Regulation 125, October 27, 1983, 19%
1984 Regulation 175, June 26, 1984, 21%
1984 Regulation 214, December 20, 1984, 23%

Plaintiff has represented to the Court that no changes in the interest rate have been made since December 20, 1984.

the language of Regulation 755, which is quoted above and cited in *Segoria*, is immediately followed by language which states, "[t]herefore, the types of interest rates *stipulated* in the acts and contracts entered into prior to that date . . . shall continue in effect until the expiration date agreed upon in the respective acts or contracts." Regulation 755 (emphasis added). This language indicates that the new interest rate will not apply to any existing contracts which had already stipulated the interest rate. However, in situations where no interest rate has been agreed upon by the parties, the current legal rate of interest should be held to apply.

For this reason, we find that the rate of prejudgment interest shall begin at 8 percent per annum and increase in accordance with increases in the Ecuadorian legal rate of interest.

IV. LIABILITY OF PARENT CORPORATION.

Phoenix asks the Court to find liability not only on the part of the subsidiaries, Texaco Ecuador and Gulf Ecuador, but on the part of the parent corporations, Texaco and Gulf. Since we have ruled that the subsidiaries did breach the 1965 Contract in their calculation of the two percent payments for the disputed quarters, we must now examine this claim against the parent corporations. Plaintiff advances the theory that liability rests with the parents because the subsidiaries were acting purely as agents of the parent corporations in all matters relevant to this cause of action.

Both parties agree that Delaware law should apply to this question.[42] There are essentially two general theories of liability under which a parent corporation may be held responsible for the obligations of its subsidiaries. Some courts, using the

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42 Judge Schwartz in *Phoenix II* has already held that Ecuadorian law should apply to the substantive issues in this case. However, Judge Schwartz did not address the issue of whether Gulf and Texaco may be held liable for the obligations of their subsidiaries. Because the subsidiaries here are Delaware corporations, and one of the parent corporations, Texaco, is a Delaware corporation, it is appropriate that Delaware law be applied in deciding this issue of parent corporation liability for the activities of its subsidiary. *Japan Petroleum Co. (Nigeria) Ltd. v. Ashland Oil*, 456 F. Supp. 831, 840 (D.Del. 1978).

phrases "pierce the corporate veil", "alter ego" or "instrumentality", have imposed liability on the parent corporation only when there is a showing of fraud or inequity. *See Sears Roebuck and Co. v. Jardel Co.*, 421 F.2d 1048, 1053 (3rd Cir.1970); *Pauley Petroleum Inc. v. Continental Oil Co.*, 239 A.2d 629, 634 (Del.1968); *Skouras v. Admiralty Enterprises, Inc.*, 386 A.2d 674, 681 (Del.Ch.1978). Other courts have based liability of the parent on the principles of agency, without reference to fraud or inequity. *See Japan Petroleum Co. (Nigeria) Ltd. v. Ashland Oil, Inc.*, 456 F.Supp. 831, 839-840 (D.Del. 1978).

Phoenix bases its claims of parent liability on the agency theory only. Under the agency theory, the issue of liability rests on the amount of control the parent corporation exercises over the actions of the subsidiary. The parent corporation will be held liable for the activities of the subsidiary only if the parent dominates those activities. *Id.* at 841. Factors to consider in determining whether "domination" exists include "stock ownership, officers and directors, financing, responsibility for day-to-day operations, arrangements for payment of salaries and expenses, and origin of subsidiary's business and assets." *Id.*; *Fish v. East*, 114 F.2d 177, 191 (10th Cir. 1940).

Both Gulf Ecuador and Texaco Ecuador were wholly owned subsidiaries of their parent corporations. This alone does not make a subsidiary the agent of its parent. *Scott-Douglas Corp. v. Greyhound Corp.*, 304 A.2d 309, 314 (Del.Super.1973). The boards of directors of Gulf Ecuador and Texaco Ecuador were separate from those of the parent corporations although there were officers and directors common to the boards of both parent and subsidiary. Again, this similarity by itself does not indicate an agency relationship. *Japan Petroleum*, 456 F.Supp. at 841. The parent corporations were also involved in the substantial financial decisions of the subsidiaries. According to Robert Shields,[43] Texaco Ecuador needed the approval of Texaco to get money for very large investments and for the acquisition or sale

43 Robert Shields was Chairman of the Board and Chief Executive Officer of Texaco Ecuador and Vice President in charge of production in Latin America at Texaco, Inc.

of major assets.[44] Gulf Ecuador also sought approval from its parent on policy matters and major financial matters.[45]

On the other hand, each subsidiary kept books and records completely separate from the parent corporation; each maintained its own bank accounts and paid its own taxes. The subsidiaries, although Delaware corporations, had their principal places of business in Ecuador and were completely responsible for their day to day operations in that country. This included drilling oil wells, building the pipeline, and participation in the management of these projects. The 1973 Exploitation Contract, the June 14, 1974 Acta and the 1977 Transfer Agreement were all executed by Texaco Ecuador and Gulf Ecuador.

In a case decided in this Court, *Japan Petroleum*, 456 F.Supp. 831, a Nigerian corporation sued a Kentucky corporation and two of its wholly owned subsidiaries for breach of contract. The Court noted that no agency relationship existed between the subsidiary and parent in spite of substantial evidence of joint operations. The Court found that the parent was very active administratively and monetarily in getting the operations of the subsidiary started, most of the officers and directors were the same, the parent provided consulting services to the subsidiary, all expenditures over $250,000 had to be approved by the parent, the parent paid the salaries of all non-Nigerian employees of the subsidiary, the parent guaranteed three major bank loans of the subsidiary and the annual report of the parent reported that the operations of the subsidiary were actually the operations of the parent. *Id.* at 842, 843.

In spite of all these factors, the Court determined there was sufficient indicia of separate corporate ownership to keep the subsidiary from being considered the agent of the parent. For example, the subsidiary was an operating corporation with obligations and rights of its own in Nigeria, the Nigerian government exercised extensive control over the operations of the subsidiary, the subsidiary had its own bank accounts and a substantial book value, the bank loans had been repaid by the subsidiary, the subsidiary had its own offices in Nigeria, hired its

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44 T-1256.

45 T-1575.

own employees and debited its accounts for any salaries paid by the parent. In essence, "the overall picture . . . is not one of complete domination or control." *Id.* at 844-845.

In light of the facts in *Japan Petroleum*, it can hardly be said that the facts presented to the court in this case show complete domination or control by Texaco and Gulf over their subsidiaries. Gulf Ecuador and Texaco Ecuador, not the parent corporations, were authorized to exploit the oil reserves in the Transfer Zone and carried out the day to day activities, required to accomplish this. The facts of this case seem to indicate even less control by the parent corporations than was exercised by the parent in the *Japan Petroleum* case. Therefore, we conclude that Texaco and Gulf shall not be held liable for the activities of their subsidiaries.

CONCLUSION

For the reasons stated above, judgment is granted in favor of defendants on the claim of unjust enrichment. On the claim of breach of contract, based on the miscalculation of the two percent payments for the three quarters at issue, judgment is granted in favor of plaintiff against Gulf Ecuador and Texaco Ecuador but not against the parent corporations. Plaintiff shall submit an Order, awarding damages of $365,479 against Gulf Ecuador and Texaco Ecuador, with interest to be computed as set out above.

APPENDIX C

Affidavit of Dr. Miguel Antonio Veron
Sworn to December 9, 1966 and Exhibits
(English only)

C1

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Civil Action No. 76-421-JRR

PHOENIX CANADA OIL COMPANY LIMITED,

Plaintiff,

v.

TEXACO INC., GULF OIL CORPORATION (now, by change of name, Chevron U.S.A., Inc.), TEXACO PETROLEUM CO. & ECUADORIAN GULF OIL CO.,

Defendants.

AFFIDAVIT OF DR. MIGUEL ANDRADE VAREA
SWORN TO DECEMBER 9, 1986 AND EXHIBITS

C2

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

C.A. No. 76-421-JRR

PHOENIX CANADA OIL COMPANY LIMITED,

Plaintiff,

—v.—

TEXACO INC., GULF OIL CORPORATION (now by change of name, Chevron U.S.A., Inc.), TEXACO PETROLEUM CO. & ECUADORIAN GULF OIL CO.,

Defendants.

AFFIDAVIT OF DR. MIGUEL ANDRADE VAREA ON THE LAW OF ECUADOR

REPUBLIC OF ECUADOR	)	
PROVINCE OF PICHINCHA	)	
CITY OF QUITO	)	ss.:
EMBASSY OF THE UNITED	)	
STATES OF AMERICA	)	

MIGUEL ANDRADE VAREA, duly sworn, deposes and says:

1. My office address in 4th Floor, Edificio "Pinzon," Pinzon 511 y Ave. Orellana, Quito, Ecuador.

2. My qualifications to make this affidavit on certain aspects of the laws of Ecuador are as follows:

— I attended the Faculty of Jurisprudence Political and Social Sciences at the Central University of Ecuador in Quito, Ecuador. I was awarded the degrees of Doctor of Jurisprudence and Attorney of the Courts and Tribunals in 1971. I was immediately admitted to the bar of Quito and since then I have prac-

ticed law continuously in Ecuador specializing in Commercial Law.

— From 1972 to 1976 I worked as an attorney in Superintendency of Companies on a part-time basis and then, until the end of 1977, I was legal advisor to the office of the Attorney General of the Nation.

— I have prepared and presented courses and lectures of Ecuador's banking and commercial laws at the Ecuadorian Insurers Association, the Catholic University of Ecuador, and various companies.

— I have been legal advisor on Ecuadorian law for the Bank of America National Trust and Savings Association for fifteen years; I have given legal advice from time to time to various United States companies and their subsidiaries in Ecuador. I represent various Ecuadorian and foreign corporations, including: Pirelli S.A. Compania Industrial Brasileira (Brazil); Scarsdale Holding Co. (U.S.A.); S.H.C. Interamerica Inc. (Panama); Doralexis International Inc. (Panama); Banco Exterior de Espana y de los Andes EXTEBANDES S.A. (Spain); Tele Redes e Telecomunicacoes Ltda. (Brazil); Engenharia de Telecomunicacoes e Eletricidade S.A. (Brazil); Textiles Nacioneles TENASA S.A. (Ecuador); Industria Textil INDUTEX S.A. (Ecuador); Froil Petroleo y Tecnologia S.A. (Ecuador); Agroflora C. Ltda. (Ecuador); Florecer C. Ltda. (Ecuador); Quito Motors S.A.C.I. (Ecuador), etc.

3. I am familiar with the facts and background in this action. I have read the Opinion of this Court dated July 20, 1984, as modified by orders dated May 17 and June 11, 1985, and the Opinion of this Court dated April 8, 1983. I have also read and studied the Spanish text of the contract dated July 16, 1965 entered into by Minas y Petroleos del Ecuador, C.A. ("Minas") and Compania Texaco de Petroleos del Ecuador, C.A. and Gulf Ecuatoriana de Petroleos S.A. ("1965 Contract"); the copy of the Public Instrument (sometimes described as the "Deed" in these proceedings) dated February 23, 1966 executed by Minas and Compania Petrolera Pastaza C.A. and Compania Petrolera Aguarico S.A.; Decree No. 602 issued by

the President of the Republic of Ecuador on May 29, 1973; Resolution No. 11927 issued by the Minister of Natural Resources and Energy (the "Minister") on June 3, 1974; and the Sentencia issued by the Minister on October 2, 1974. I have also read and studied the codes, laws, decrees, regulations, resolutions, and other documents hereinafter mentioned. Finally, I have read and studied the "Plaintiff's Post-Trial Brief" of November 10, 1986.

Duplication of Obligations. Obligation of Texaco Petroleum and Ecuadorian Gulf to act as retaining agents with respect to income taxes for the possible payments which they might have to make to Phoenix Canada Oil Company Ltd. in relation to the July 16, 1965 contract for the transfer of hydrocarbons rights and an unfavorable judgment in this action.

4. The attorneys for defendants have asked me to express my opinion as to the situation which would result if Phoenix were to obtain a judgment from this Court accepting its claim for unjust enrichment, and if Texaco Petroleum and Ecuadorian Gulf, in compliance with the judgment, paid the referenced amount directly to Phoenix: (A) Texaco Petroleum and Ecuadorian Gulf would be violating Ecuadorian law if they did not act as retaining agents for the tax, and (B) Texaco Petroleum and Ecuadorian Gulf would be liable to pay to the Government of Ecuador 86% of the value of the judgment, in addition to the amount paid to Phoenix.

5. It is my opinion that if Phoenix obtained a judgment from this Court on its unjust enrichment claim and Texaco Petroleum and Ecuadorian Gulf were to pay the amount of the judgment directly to Phoenix, they would be: (a) Violating Ecuadorian law; and (B) Obligating themselves to pay to the Government of Ecuador 86% of the amount they paid to Phoenix. I base my opinion on the provisions of Decree No. 602, Ministerial Resolution No. 11927 and the October 2, 1974 Ministerial Sentencia or Judgment.

6. Decree No. 602 established an 86% tax on:

> "Art. Income from mineral or hydrocarbon assignments or transfers. All income generated by premiums, percentages or other kinds of participations established for assignments or transfers of mining or hydrocarbon concessions, shall be subject to a sole and definitive tax of 86 percent. In the determination and payment of this tax no deductions or exonerations shall be considered, nor shall such income form part of the global income. The assignees shall be agents for the retention of this tax and consequently, jointly liable with the persons subject to the tax obligation."

Decree No. 602 also provides that the assignees of hydrocarbon exploitation contracts, in this case Texaco Petroleum and Ecuadorian Gulf, must withhold the 86% tax and pay it directly to the Central Bank of Ecuador ("the Central Bank") each quarter.

According to Article 28 of the Ecuadorian Tax Code, retaining agents are responsible for payment of taxes when they are obligated by a legal mandate or regulation to withhold a tax.

The responsible persons, according to Article 25 of that same code, are persons who without having the character of taxpayers must by law comply with the obligations conferred on a taxpayer.

7. Article 4 of Ministerial Resolution No. 11927 provides that Texaco Petroleum and Ecuadorian Gulf must deposit 100% of the 2% payments in the Central Bank. The October 2, 1974 Sentencia of the Minister reaffirms the provisions of Resolution No. 11927 and clarifies that they are applicable to Texaco Petroleum and Ecuadorian Gulf.

8. I am informed that Texaco Petroleum and Ecuadorian Gulf, in compliance with Decree No. 602 and Resolution No. 11927, have paid the 86% tax provided for by Decree No. 602 to the Central Bank on all 2% payments that they have made. Additionally, since June 3, 1974, the effective date of Resolution No. 11927, Texaco Petroleum and Ecuadorian Gulf have

deposited the entire amount of the 2% payments in the Central Bank in compliance with Article 4 of the Resolution.

9. Based on the theory of this claim, if Phoenix were to obtain a favorable judgment on its unjust enrichment claim, the amount recovered would be restitution for 2% payments that Phoenix claims Texaco Petroleum and Ecuadorian Gulf should have paid. Any judgment which recognizes Phoenix's right to receive a sum based directly on, or in relation to the 2% payments mentioned previously, would have as its origin the July 16, 1965 contract for the assignment of Minas' hydrocarbons concession and therefore said sum would be subject to the 86% tax imposed by Decree No. 602, and the payment of such amount would be subject to the provisions of Resolution No. 11927 and the October 2, 1974 Sentencia. Texaco Petroleum and Ecuadorian Gulf could not by the express legal mandate pay directly to Phoenix the amount indicated in the judgment without violating their legal obligation to act as retaining agents in compliance with Decree No. 602 and Ministerial Resolution No. 11927. The Government of Ecuador would then have to make one of the following claims: (A) To order that Texaco Petroleum and Ecuadorian Gulf pay to the Central Bank an amount at least equal to 86% of the total paid to Phoenix, in satisfaction of the tax in Decree No. 602; or (B) that the companies Texaco Petroleum and Ecuadorian Gulf pay to the Central Bank an amount equal to 100% of the judgment, in satisfaction of the deposit requirements of Article 4 of the Resolution No. 11927. In other words, the companies Texaco Petroleum and Ecuadorian Gulf would be liable to the Government of Ecuador for at least 86%, and possibly 100% of any payment they made directly to Phoenix in the United States. This last (100%) for the obligation of Phoenix to invest 50% of the 14% in Ecuador.

PREJUDGMENT INTEREST

10. I have been asked by the attorneys for defendants to render an opinion as to whether Phoenix would have the right to prejudgment interest for its claim for unjust enrichment and reliquidation of the three disputed quarters. If so, I have been

asked to give my opinion as to the rate at which interest would be calculated.

11. Under the laws and jurisprudence of Ecuador, prejudgment interest cannot be assessed on an undetermined claim which is not liquidated. When neither the obligation nor the amount have been clearly established, it is impossible for the debtor to comply. Consequently, non-compliance cannot occur. Prejudgment interest is indemnification for non-compliance with the obligation to pay a sum of money.

Under Article 1611 of the Civil Code: "Effective payment is the presentation of what is owed." In this case, as long as the Court has not ordered that Phoenix should receive an amount from Texaco Petroleum and Ecuadorian Gulf and has not set the amount, the companies cannot, though they may wish to, pay any amount and, therefore, they are not in default or non-compliance and should not be compelled to pay prejudgment interest.

Arturo Alessandri, in his work, "Theory of Obligations", pages 64-65, states:

> "If the creditor does not have the title which makes his right undisputable, if [he] cannot exhibit any of the instruments that are narrowly defined in Article 456 of *C. de P. Civil* [450 of the Ecuadorian Code], it will be necessary for a prior proceeding in an ordinary trial with his debtor to establish proof of the effectiveness of his right, and only when the judicial judgment has recognized the effectiveness of his right, or has declared his status as a creditor, shall [he] have in his hands the executory title enumerated in Article 456 of the *C. de P. Civil.*"

12. The foregoing principles are described in the case of *Antonio Aragundi v. Abdon Gilbert* (Dictionary of Supreme Court Jurisprudence, Galo Espinosa, Volume II, Quito, Ecuador, p. 370 (1974)). In that case there was no definite or certain sum claimed in the initial action ("juicio ordinario"). Accordingly, the plaintiff in the first action had to first, obtain a judgment which declared his rights and then, bring a second action ("juicio ejecutivo") to execute on the judgment in the initial

action. The Supreme Court of Ecuador held in that case that prejudgment interest would not begin to accrue on plaintiff's claim until service of the "juicio ejecutivo" because the amount due was not made definite or certain until that time.

13. I have read Phoenix's Complaint and its Supplemental Complaint in this action. Phoenix has not specified the amount it seeks to recover on its unjust enrichment claim in either document. I understand that the very issue of unjust enrichment is strongly denied by defendants; and that Phoenix has changed its theory of recovery on its unjust enrichment claim during the course of the litigation. Moreover, Phoenix's claim is not for a sum certain, but for the amount it considers "fair" (see Plaintiff's Post-Trial Brief at pp. 13-14, 28-29) of certain amounts received by Texaco Petroleum and Ecuadorian Gulf from the Government of Ecuador, as calculated by its expert witness for the first time in 1985 and subsequently modified at trial in 1986. Under these circumstances, I am of the opinion that the amount of the claim is not ascertainable until entry of judgment, and prejudgment interest, which is a sanction for delay in payment, would not be available.

14. In the case that the Court were to grant prejudgment interest, it would accrue only from the dates of service of the Complaint and Supplemental Complaint, at the rates in effect on the dates of service. The rate in effect at the time of the service of process remains fixed and does not change even though during the process the rate [of interest] may change. In the absence of any stipulation, prejudgment interest is at the legal rate of interest. See Article 7 of the Civil Code; Monetary Board Resolution 755, Article 8, of January 16, 1975; Jurisprudence of the Supreme Court of Justice of Ecuador, Judgment No. 341, Judgment *Segovia v. Agosta*, Third Chamber, November 11, 1977 (Juan Larrea Holguin, Jurisprudential Digest, Corporation of Studies and Publications, Volume III, Quito, 1983, p. 107).

15. I have been informed that the Complaint in this action was served on Texaco Petroleum on December 3, 1976 and on Ecuadorian Gulf on December 1, 1976. I also have been

informed that the Supplemental Complaint was served on both Texaco Petroleum and Ecuadorian Gulf on November 17, 1978. The legal rate of interest in effect in Ecuador on each of the mentioned dates was 8%. Such rate is fixed in Monetary Board Resolution 755, Art. 8, of January 16, 1975. Accordingly, assuming that this Court were to determine that the plaintiff has rights to prejudgment interest, such interest would accrue at the rate of 8% annually from the dates of service of the Complaint and Supplemental Complaint. Moreover, the companies Texaco Petroleum and Ecuadorian Gulf in that case would have to deposit any interest payments in the Central Bank in accordance with their obligations as retaining agents under the terms of Decree No. 602 and Art. 4 of Resolution No. 11927.

CONCLUSION

18 [sic]. In view of the above, I am of the opinion that:

A) If the Court finds in favor of Phoenix on its unjust enrichment claim and Texaco Petroleum and Ecuadorian Gulf pay money directly to Phoenix, the defendant companies would violate Ecuadorian law if they complied with such decree without acting as retaining agents; and they would be subject to double liability for 86% or 100% of the amount fixed in the judgment;

B) Prejudgment interest in Ecuador is unavailable on the plaintiff's claim for unjust enrichment since there is no declared or established obligation nor a definite or a certain sum due on this claim; and

C) In the case that the Court directs prejudgment interest, such interest would accrue from the dates of service of the Complaint and Supplemental Complaint and it would be calculated at the legal interest rate in effect in Ecuador at that time, which was 8% annually.

/s/ Dr. Miguel Andrade Varea

Subscribed and sworn before
me on this 9th day of
December, 1986

Michael Joseph McCamman
Consul of the United States
of America

EXHIBITS TO AFFIDAVIT OF DR. MIGUEL ANDRADE VAREA

Article 1611 of the Civil Code of Ecuador (Spanish & English)	Exhibit A
Arturo Alessandri, *Theory of Obligations*, Professional Library, Bogota, Colombia, pp. 64-65 (1983) (Spanish & English).....	Exhibit B
Antonio Aragundi v. Abdon Gilbert, Dictionary of Supreme Court Jurisprudence, Galo Espinosa, Volume II, Quito, Ecuador, p. 370 (1974) (Spanish & English)	Exhibit C
Article 7 of the Civil Code of Ecuador (Spanish & English)	Exhibit D
Monetary Board Resolution 755, Article 8, of January 16, 1975 (Spanish & English)	Exhibit E
Segovia v. Acosta, Judgment 341, Supreme Court of Ecuador, Third Chamber, November 11, 1977 (pp. 426-437) (Spanish & English).....	Exhibit F
Articles 25 and 28 of the Tax Code of Ecuador (Spanish & English)	Exhibit G

EXHIBIT A

Civil Code

1611. Effective payment is the presentation of that which is owed.

EXHIBIT B

A.—The Forced Execution

As I said a moment ago, the norm in law is that a debtor voluntarily agrees to comply with his obligation. In such a case, he should comply exactly, in other words, totally and opportunely at the time and place agreed upon, effecting the act or abstention owed and not a different one. If the obligation is to give, the debtor should give the exact thing owed at the place and time agreed upon; if the obligation is to do [something], the debtor should effect the exact deed he is bound to and not another, and at the opportune time; and if the obligation is no to do [something], the debtor should abstain from effectuating the forbidden deeds in the form agreed upon.

But it can happen—and this happens more frequently than is convenient—that the debtor refuses to comply with the obligation, that [he] violates his agreement, that [he] resists the execution of that to which he bound himself. The law, in such a case, goes to the help of the creditor, and authorizes him to request the protection of the State in his favor, and the State gives him this protection by means of tribunals of justice, which constitute the public power that has the mission of obtaining the recognition of rights, and resolving disputes which due to such (rights), arise between parties. And these Tribunals will give to the creditor the means that the debtor does not mock his promise, means that are no other than those necessary to procure the forced compliance with the obligation through public authority, and which are translated into compelling the debtor to comply with that to which he obligated himself, even against his will, by means of public force.

In order for the forced execution to proceed, it is necessary for the creditor to have a liquidated debt, actually demandable, and that he have an executory right, in other words, an authentic document that sets the right of the creditor beyond doubt.

Those listed in article 456 (455) of the *C. de P. Civil* are executory rights, among them, firm judgments, be they final or interlocutory; public deeds, provided they are a first copy, or other latter ones given by judicial decree and citation of the per-

son concerned or that causes it; or a private instrument judicially recognized or having been ordered recognized, etc.

If the creditor does not have the title which makes his right undisputable, if [he] can not exhibit any of the instruments that are narrowly defined in article 456 of *C. de P. Civil*, it will be necessary for a prior proceeding in an ordinary trial with his debtor to establish proof of the effectiveness of his right, and only when the judicial judgment has recognized the effectiveness of his right, or has declared his status as creditor, shall [he] have in his hands the executory title enumerated in article 456 of the *C. de P. Civil*.

In reality, and given the above, it is understood that the forced execution is nothing other than the proceeding or executory procedure regulated by procedural law, since there is only room for forced execution of an obligation in cases in which, according to the *Codigo de Procedimiento*, the executive power proceeds.

The forced execution shall proceed when it is possible to initiate an executive proceeding, because in the contrary case, it is necessary for the creditor to discuss with the debtor the existence of his right, and obtain the recognition of the obligation or the recognition of his status as creditor, through a judgment that puts an end to said ordinary proceeding.

Now then, what shall be the object of the forced execution? Over what shall be made effective this right which the law gives the creditor, to be able to compel the debtor by forcible means to comply with the payment? It is an old aphorism of law that whoever obligates himself, obligates all his property. Thus, what is affected to the compliance of the obligation is the patrimony of the debtor, in other words, his property and not his person. The person of the debtor is not effected, in modern law, to the compliance with the obligation.

This right is consecrated among us, in first instance, by article 1624 of the *C. Civil*, which establishes: "That which is stipulated regarding assignments in articles 1618 and following, is applied to the embargo of property by the executory proceeding of the creditor or creditors; but as for the exemption to a suit for collection we should comply with the stipulations in the Code of Civil Procedure"; and immediately after, articles 2465

and 2469, which authorize each creditor individually, and all of them together, to request that all the property of the debtor, with the exception of those [which may] not be embargoed, be sold in order to pay the creditors with the proceeds. In this respect, article 2465 says: "All personal obligation gives the creditor the right to pursue its execution over all the real and personal property of the debtor, be they present or future, with the only exception of those that may not be embargoed, designated in article 1618". On the other hand, article 2469 establishes: "Creditors, with the exceptions indicated in article 1618, shall be able to demand that all the property of the debtor be sold to meet the total payment of his debts, including interest and collection costs. so that with the product [of the sale] they can be totally sati ed if the property be enough, and in case they are not, a prorata, when there are no special causes to prefer certain credits, according to the classification that follows".

On the other hand, paragraph 1 of article 1618 says: "The assignment shall comprise all property, undivided interests ["derechos y acciones"] of the debtor, with the exception of the ones (that can) not be embargoed".

EXHIBIT C

No. 113.—Suit for execution of money [judgment]
which is prosecuted by
Antonio Aragundi V. against
Dr. Abdon Gilbert M. Guayaquil

THIRD INSTANCE

"Quito, on April 26, 1971; at 3 p.m. IN VIEW OF: Antonio Aragundi Vasquez, founded upon the original judgment issued in the ordinary suit which he brought against doctor Abdon Arturo Gilbert Moncada, and which was decided in the last instance by this same Chamber of the Supreme Court, demands execution from the said doctor Gilbert Moncada, payment of the sum of two hundred eight thousand sixty Sucres, fifty-five centavos, the applicable interest, and procedural costs. The First Provincial Court of Guayas and the First Chamber of the Superior Court of Guayaquil ruled in favor of the complaint. To resolve the appeal at the third instance filed by the debtor, it is observed: FIRST.—The person against whom execution was sought presented in his defense the following allegations: 1) offset; 2) partial payment; 3) demand for excessive damages; 4) not having filed the complaint in accordance with law. Which in this case, because it concerned a complaint for execution should simply have been settled apart from main trial; 5) having sought a prohibition from alienating the entire property "La Avelina", in spite of the fact that the defendant has only an undivided interest ("derechos y acciones") in it, because besides his, there exists rights of usufruct in favor of Clara Gilbert Moncada, and of co-proprietorship in favor of Pedro Gilbert Moncada; 6) the complaint can not be executed because there has not been carried out a proper execution; 7) that he is not obligated to pay interest because the judgments of the underlying suit neither establish it nor determined the type [of interest]; 8) that the judge did not resolve an issue presented by the defendant in the underlying suit. SECOND.—The exception of offset cannot be dealt with because the indispensable foundations of fact and

law, required by law on which it is based have not been pled. This is especially applicable in the present instance which demands, for its justification, the concurrence of several requisites which, at any rate, are not even legally established in the evidence presented by the defendant, nor similarly are the exceptions of partial payment and demand for excessive damages. THIRD.—The requirements of Art. 522 of the *Codigo de Procedimiento Civil*, according to which executory judgments rendered in ordinary suits, and which in accordance with Art. 450 constitute executable judgments may be executed on the basis of the original judgment, as occurs in the present case. On the other hand, the execution to which the defendant makes reference in his exception sixth has been carried out in accordance with law. FOURTH.—Even though the judgment on which the execution is based does not provide for the payment of interest, the Plaintiff has the right to it, at the legal rate, from the date of the citation with the complaint [in execution] because said resolution contains the acknowledgement of a credit in favor of the claimant and which has not been satisfied by the defendant, which is considered in default from the date of the citation with the complaint (No. 5 of Art. 99 of the *Codigo de Procedimiento Civil*). FIFTH.—Exception eighth refers to an incident resolved definitely in original suit and which is foreign to the present proceeding. SIXTH.—The allegation contained in number five of the answer to the complaint is acceptable even though it does not have to do with the principal matter of this case. The prohibition of alienating the totality of the landed property La Avelina should not have been ordered because the defendant is not the sole proprietor of this tenement. A punctuation error in the certificate of the Property Registrar in folio 62 has led to maintaining this prohibition in the two decisions which have been appealed; but the certifications appended in the second instance show that the heirs of Pedro Gilbert Moncada have proprietary rights and his sister Clara a life usufruct in the above-mentioned real estate. The prohibition of alienation must, therefore, be limited to the undivided interest ("derechos y acciones") corresponding to doctor Abdon Arturo Gilbert Moncada in the aforementioned landed tenement. For these reasons, ADMINISTERING JUSTICE IN THE NAME OF THE REPUBLIC AND BY

AUTHORITY OF THE LAW, the verdict from below is confirmed, modified only as that the payment of the legal interests will run only from the date of the citation of the complaint, and that the prohibition of alienation of the tenement La Avelina must be limited to the undivided interest ("derechos y acciones") which the defendant has in it. With costs. The fees of the counsel for the defense are hereby fixed as one hundred Sucres for his intervention in this instance. The Chamber finds the procedural conduct of the defendant reproachable; warning his counsel that if he persists in the processal attitude maintained in this execution, [he] will be sanctioned.—Francisco Paez R.—J. M. Villagomez R.—E. Ponce y Carbo."

It is a true copy

The Secretary,

(signature)

EXHIBIT D

Civil Code

§ Effects of the Law

7.—Law disposes only of that which is to come: it does not have retroactive effect; and in [the event of] a conflict of a later law with a prior one, the following rules will be observed:

1st.—Laws which establish, for the obtaining of a civil status, conditions different from those prescribed in a previous law, shall prevail over the latter from the day they begin to govern;

2nd.—A civil status acquired in accordance with a law in effect at the date of its establishment shall remain, even though such law ceases to govern; but the obligations and rights inherent in it shall be subordinated to the latter law, be it that they constitute new rights or obligations, or that they modify or annul the former. Consequently, the subordination or dependence between spouses, parents and children, guardians and wards, etc., shall be subject to the new law from the time it enters into force, without prejudice to the effect of the acts validly carried out under the rule of a prior law;

3rd.—The rights of legal usufruct and of administration which the head of a family might have of the assets of a child, and which had been acquired under a previous law, shall be subject, as to their exercise and duration, to the provisions of the latter law;

4th.—Persons who under the terms of the law had acquired the status of illegitimate children, shall retain that status, shall benefit from all its advantages, and shall be subject to all the obligations imposed on them by a latter law;

5th.—A child who had acquired the right to support under the terms of a law, shall continue to benefit from such rights under the latter law. But as to the enjoyment and termination of this right, the rules of the latter law shall be followed;

6th.—Mere expectations do not constitute a right;

7th.—A person who, according to the dispositions of a law has acquired the right to administer his assets, shall not lose it even when a latter [law] prescribes new conditions to acquire it; but the continuation and exercise of the right shall be subject to the new law;

8th.—Guardians and other administrators of other people's assets, validly constituted under a prior law, shall continue to exercise their duties in conformity with the latter, even if under the latter they would have been incompetent to obtain them. But, as to their functions and remuneration and their incompetence or supervening exemption, the new law shall be observed;

As to the penalty which, due to carelessness or bad administration, they would have incurred, they will be subject to the rules of the law which are least harsh; but the faults committed under the new law shall be penalized in conformity with the latter;

9th.—Every real right acquired according to a law, subsists under the authority of a new one; but as to the enjoyment and duties, and as to its termination, the dispositions of the latter law shall prevail;

10th.—Ownership acquired according to a previous law is not retained, lost or recovered under a later law, except through the means and requirements prescribed in it;

11th.—Rights granted under a condition, which according to the new law, has to be considered terminated if it is not effected within a certain time, shall subsist for the time specified in the previous law, unless it exceeds the period set forth in the latter law, measured from the date in which the latter [law] enters into effect; for, in such case if the condition is not complied with within the period, it will be looked upon as terminated;

12th.—Whenever a new law prohibits the establishment of various successive usufructs, and the first one having expired before the law becomes effective, one of the following usufructuaries having started to enjoy it, he shall continue to enjoy it under the mandate of the new law, for the entire time his title

authorizes him; but the right of later usufructaries, if there be any, will expire;

The same rule is applicable to successive uses or habitations and to trusts;

13th.—Easements validly constituted under the mandate of a law shall be subject to a later [law], as to its continuance and exercise;

14th.—The external solemnities of wills shall be subject to the law in effect at the time of their execution; but the dispositions in them shall be subordinated to the one [law] in effect at the time of the death of the testator;

Therefore, they [the latter laws] shall prevail over the laws prior to the death of the testator as to absence of capacity or indignity of the heirs or legatees, legitimacy, improvements, conjugal shares and disinheritances;

15th.—If the will contains dispositions that should not be carried out, according to the law under which it was executed, [the dispositions] shall be complied with, nevertheless, as long as they do not contradict the law which is in effect at the time of the death of the testator;

16th.—In forced or intestate successions, the right of representation of those called to them shall be ruled by the law in effect at the time of the death of the intestate;

But if the death takes place under the rule of one law, and the will executed under the mandate of another, a person should have been called voluntarily who failing the direct beneficiary, succeeds in whole or in part of the inheritance by right of representation, such person shall be determined by the rules to which the right was subject, according to the law under which the will was executed;

17th.—In the adjudication, partition of an inheritance or legacy, the rules in force at the time of the death of the person that is succeeded shall be observed;

18th.—In every contract, the laws in force at the time of its execution shall be understood as being incorporated.

Excepting from this disposition: 1) the laws concerning the way to sue for the rights resulting from the contract; and 2) those which indicate penalties in the case of infraction of what has been stipulated in the contracts; since this shall be punished in accordance with the law under which it has been committed;

19th.—Acts and contracts [actos y contratos] validly entered into under a law, can be proven, under the mandate of another, by the means the former established to justify them; but the way the proof is to be made shall be subject to the law in force at the time it is to be made;

20th.—Laws concerning substantiation and formalities in lawsuits prevail over the prior ones from the moment they become effective. But the time periods which begin to run and the proceedings and formalities that have already begun shall be ruled by the law that was then in effect;

21st.—The prescription which started under the rule of a law, and which had not been completed at the time of the promulgation of another that modifies the prior one, reducing the term for the prescription, shall be ruled by the first or second, at the will of the prescribing party; but he may not take advantage of the second until after two years from its promulgation;

In pending judicial matters at the time of the promulgation of a law that modifies the term for the prescription, the law in force at the time that the proceedings were started shall rule;

22nd.—What a later law declares absolutely imprescriptible shall not be gained by time, under the mandate of the new law, even when the prescribing party might have started to possess under the prior law that authorized the prescription; and

23rd.—Laws which are limited to interpreting other laws shall be understood as incorporated in them; but they shall not alter in any way the effects of the judicial decisions executed in the meantime.

C23

EXHIBIT E

10 No. 728—REGISTRO OFICIAL—JANUARY 23—1975

No. 755

THE MONETARY BOARD,

Considering:

That it is necessary to reform interest rate policy in order to facilitate financial intermediation with priority for the productive sectors;

That the *Ley de Regimen Monetario* [Law of the Monetary Regime] empowers the *Junta Monetaria* [Monetary Board] to set maximum rates which regulate the money market; and,

By the authority set forth in literal (b) of Art. 142 of the *Ley del Regimen Monetario*,

Resolves:

Art. 1—The following types of annual interest for active credit operations are established:

I. Conventional and legal interest

1.—Legal (Article 2137 of the Civil Code and Article 414 of the commercial Code)	8%
2.—Maximum civil or mercantile conventional interest	[illegible]

II. In operations granted by the Central Bank

1.—To private banks:

a) Rediscounts and advances	
— Agricultural and livestock, fishing and crafts	[illegible]
— Industrial	[illegible]
— Commercial	[illegible]
b) Extraordinary advances	[illegible]
c) Advances to cover temporary deficits in the cash position	[illegible]

2.—To National Development Bank and Cooperatives Bank:
Rediscounts and Advances:

— Agricultural and livestock, fishing and crafts, including ENAC [illegible]
— Small Business [illegible]
— Commercial [illegible]

3. To public financial corporations:
a) Industrial rediscounts and advances [illegible]
b) Rediscounts of the Fund for the Promotion of Exports (FOPEX) [illegible]

4. To private financial Companies:
Rediscounts and advances [illegible]

5. To financial institutions through the mechanism of Financial Funds:

a) Rediscounts [illegible]
b) Rediscounts of active operations Over s/.625.000,00 of the Livestock Development Program (222-EC) [illegible]

6. To private persons:
Loans and Discounts [illegible]

7. To private persons through financial institutions:
a) Bankers acceptances:
— Agricultural and livestock, fishing and crafts [illegible]
— Industrial for the purchase of national agricultural raw material [illegible]
— Industrial [illegible]
— Commercial [illegible]
b) Advance on future exports 6%
Reassessment in the event of failure to export 12%

8. To the public sector:

a) Central Government 3%
b) Provincial Governments, Municipal [Governments] and other public or semi-public Entities 5%

III. In active credit operations granted by private banks and financial institutions:

(End of page 10)

— In active operations, up to	12%
— In credit contracts on current account, up to	12%
— In occasional overdrafts up to	8%
— to CV-CFN for financing under the mechanisms of the Fund for the Promotion of Exports (FOPEX), up to	8%
— To CV-CFN for rediscounts of small industry and crafts:	
a) With Private Banks	5%
b) With National Development Bank	3%

IV. In active credit operations granted by the National Development Bank and the Cooperatives Bank:

— Agricultural and livestock up to	9%
— Small Industry and crafts, up to	9%
— Commercial, up to	12%
— To National company for Storage and Marketing (ENAC), up to	4%

V. In active credit operations of the mechanism of Financial Funds:

1. In active credit operations of the Financial Institutions	9%
2. In active credit operations over s/.625.000,00 of the Livestock Development Program (222-EC)	12%

Art. 2—The Central Bank of Ecuador in the rediscount operations it grants to the Principal and Branch Offices of Banks located outside of the Quito and Guayaquil Cantons, will honor a rate of 1% lower to those set forth in Art. 1 of this Regulation as long as these operations finance productive, economic activities, other than commercial, that take place in a manner wholly

outside of said Cantons. The rediscounts of the mechanism of Financial Funds are excluded from this treatment.

Art. 3—In addition to the interest rates established for each one of the acts or contracts, an additional annual interest of 2% is fixed in the event of delay [or default].

Art. 4—The following norms and types of interest are established for passive transactions of the Banks and Institutions authorized by Law to receive deposits;

1.—The payment of interest on money and short-term deposits is prohibited.

2.—On all types of savings passbooks, there shall be payments of:

a) 6% annual interest in private banks;

b) 7% annual interest in Mutual Savings and Credit [banks] for dwellings.

3.—On long-term deposits received by the [illegible] (commercial and savings sections), the following annual interest shall be paid:

From 31 to 180 days, up to	7%
From 181 to 360 days, up to	8%
Over 360 days, up to	9%

4.—In long term deposits of the Mutual savings and credit for dwellings, including fixed-term savings deposits, the following annual interest shall be paid:

From 31 to 180 days, up to	8%
From 181 to 360 days, up to	9%
Over 360 days, up to	10%

Art. 5.—12 percent annual [interest] is fixed as the maximum interest rate which can be drawn on mortgage bonds, bonds of the State, security bonds and other bonds and obligations issued by *Sociedades Anonimas*.

Art. 6.—The development bonds that must be acquired by private banks in an amount equivalent to the corresponding value of credits not granted through the mechanism of the Financial Funds shall draw a 4% annual interest.

Art. 7.—The banking and financial institutions may not charge, under any concept or in any form, amounts in addition to the interest rates and commissions fixed by the Monetary Board, under the existing legal preventions.

Art. 8.—The provisions of the present Regulation shall apply only to the acts and contracts [*actos y contratos*] entered into from and including the date it is published in the *Registro Oficial*. Therefore, the types of interest rates stipulated in the acts and contracts [*actos y contratos*] entered into prior to that date, be they drawn or to be drawn, shall continue in effect until the expiration date agreed upon in the respective act or contract [*acto o contrato*].

Under no reason [whatsoever] may the payment of an interest rate greater than that stipulated in the acts and contracts [*actos y contratos*] entered into prior to this Regulation be required, not even if the debtor has committed himself, through a conditional clause, to pay a greater interest rate in the event of modifications to the relevant Law. Neither such a clause nor the stipulation that the contract shall expire if it is not observed, shall have any effect.

Art. 9.—Regulations No. 545 and 741 and all other provisions regarding types of interest that do not conform to this Regulation are annulled.

Given, in Quito, on January 16, 1975.

The President, s.) Econ. Jaime Moncayo Garcia, Minister of Finance.—The Secretary, s.) Dr. Galo Recalde Fdez. S.

It is a true copy.—I certify:

s.) Dr. Galo Recalde Fedz. S., Secretary of the *Junta Monetaria*.

EXHIBIT F

No. 341.—Ordinary Suit for Money which Graciela Segovia, widow of Gonzalez pursues against Dr. Francisco Acosta Yepez.—

THIRD INSTANCE

Quito, November 11, 1977;
at 10 a.m. — IN VIEW OF:—

Graciela Segovia, widow de Gonzalez, pursuing her own rights and offering a power or ratification from her daughter Maria Graciela Gonzalez Segovia de Kelly, Cecilia Gonzalez Segovia and Ing. Arturo Gonzalo Gonzalez Segovia, brings an ordinary action against the companies Material y Construcciones S.A., Material Movil y Construcciones, Antiguos Talleres Carde y Escoriaza S.A., Compania Auxiliar de Ferrocarriles S.A. and Astilleros Espanoles S.A., in the person of their legal representative and general agent in Ecuador, Dr. Francisco Acosta Yepez, with the goal that a decision declare that the companies being sued, each one in the amount corresponding to it, in other words 25% of the total amount, are obligated to pay the plaintiffs in proportion to their rights, in accordance with the roles in which they present themselves, the remuneration that they agreed with Mr. Josueth Gonzalez, predecessor in right of the plaintiffs, for the services as agent and legal representative of each of these companies in Ecuador, for business and contracts with the Empresa de Ferrocarriles del Estado Ecuatoriano, plus the corresponding legal interest from the service of process with the complaint until payment, and the court costs. They recognize the partial payment of thirteen thousand four hundred twenty six American Dollars, made directly to Josueth Gonzalez. As background they state that, within the plan for the rehabilitation of the Ecuadorian railways, the Empresa de Ferrocarriles del Estado opened, in the year of 1967, an international bidding contest for offers for the financing of said plan, for the providing of various materials for the use of the railroad and for studies and construction of the Duran-Miraflores oil pipeline; that, among others, the above

mentioned companies participated in the bidding, in a grouping called "Servicio para Exportacion de Material Ferroviario", under the acronym "S.E.M.F.", to which grouping was added the Compania Heredia y Moreno S.A., Compania Mercantil Anonima; that subsequently, all these companies formed a de-facto association under the name "Consorcio Espanol", that was, ultimately, the awardee of the contracts for the providing of materials, accessories and spare parts for the Empresa de Ferrocarriles del Estado and for the construction of the Duran-Quito oil pipeline, including the studies and means of financing; that Josueth Gonzalez Barreto acted as general agent and legal representative in Ecuador of all and each one of the companies which made up the Servicio para Exportacion de Material Ferroviario, and subsequently, of the "Consorcio Espanol", including Compania Heredia y Moreno, having taken part in the entire contracting process, for the preparatory phase of bidders' participation, the execution of the contract with the Empresa de Ferrocarriles and continuing his services as agent and legal representative until his death on October 17, 1970; that his services, naturally, had to be remunerated and, concerning the Grupo S.E.M.F., the remuneration which the principals obligated themselves to give to the agent was of thirty three thousand five hundred sixty five American Dollars, that were to be paid in the manner stipulated in the respective contract, without their having complied with such payment, with the exception of the first installment of thirteen thousand four hundred twenty six Dollars, notwithstanding the claims made by the successors of said agent. The defendant, having been served, excepts to the cause of action denying purely and simply the factual legal bases of the complaint; that the contract entered into between Josueth Gonzalez and S.E.M.F. establishes that the former should comply with several obligations in order to have the right to payment of the respective commissions, without there having been compliance with the contracted obligations by either Mr. Josueth Gonzalez nor his heirs; that they also have not complied with the obligation to present approved plans and lists of spare parts for all the contracts between the defendant companies and the Empresa de Ferrocarriles del Estado Ecuatoriano; that the warranty period

that covers the railroad material sold by the defendant companies to the Empresa de Ferrocarriles has not ended, since not all the respective documents declaring that warranties are concluded have been signed; that Mr. Josueth Gonzalez did not comply with the contract clause establishing that if in the future there exist possibilities of effecting new sales of railway supplies to the Ecuadorian railways, he was obligated to immediately notify and give absolute preference to the S.E.M.F., enterprises which he represents, since not only did he fail to notify or give preference to the companies which he represented, but he presented a bid for railway supplies in the name of other companies in direct competition with S.E.M.F.; and, lastly, counterclaims for the return on the part of the heirs of Josueth Gonzalez of what was improperly paid since, not having complied with all the contracted obligations, neither Mr. Gonzalez nor his heirs were creditors of the contracted commissions, especially for not having preferred nor offered the Spanish materials and for having presented a bid representing a competing firm. The action having been legally prosecuted without there having been considered, as should have been, the dilatory exception of the illegitimacy of the official representative, because the defendant party had withdrawn it, expressly accepting having the representation of the companies sued, the Fifth Provincial Judge of Pichincha pronounces judgment dismissing the action because the plaintiffs did not prove with any document that Josueth Gonzalez had been the agent and legal representative of the companies sued. The Second Chamber of the Superior Court of Quito to which the action has risen by virtue of the appeal made both by the plaintiffs and by the defendant, the latter only because the counterclaim was not accepted, vacates the appealed decision and declares that the plaintiffs have the right to demand from the companies sued the payment of the amount of thirty three thousand five hundred sixty five Dollars, with 6% annual interest from the service of the complaint, corresponding to each the payment of a fourth part of that total, deducting the first installment of thirteen thousand four hundred twenty six Dollars, and having to effect the conversion to Sucres since the payment of the fee which is the basis of the suit has been stipulated in foreign currency, in conform-

ity with Art. 7 of the *Ley de Regimen Monetario*. From this decision the defendant files an appeal of third instance and of nullity of the judgment based on the illegal makeup of the Chamber, based on the fact that the excusal of Dr. Vicente Garcia does not have a legal basis and, therefore, the intervention of the Adjunct Judge is illegal. The plaintiffs also appeal to the third instance concerning the unfavorable part of the decision, based on the application of Art. 7 of the *Ley de Regimen Monetario*, for having applied only the rate of interest of 6%, and on the exoneration of the payment of costs by the defendants. The action having legally risen to the next level and its consideration corresponding to this Chamber, to resolve, there is considered: FIRST:— The appeal of nullity is based on the omission of the 1st. substantial solemnity of Art. 374 of the *Codigo de Procedimiento Civil*. Said omission does not exist since the excuse presented by the Minister Judge of the Second Chamber of the Superior Court of Quito, Dr. Vicente Garcia, has been qualified and accepted by the legally qualified Minister and the Adjunct Judge who had been dealing with the action, the other Adjunct Judge having been called to complete the Chamber, thus being legally made up that heard and resolved the action in the second instance. And, even in the event that there was a reason existing for the alleged nullity, its declaration would not stand since the circumstances established in Art. 380 of the cited *Codigo* did not occur, since it would not influence the decision in the case, nor was nullity alleged in the respective instance when the defendant was notified of the decision at which time the reason can be accepted, but only when the decision was reached and with the appeal of the third instance was nullity interposed. Therefore, the point appealed is dismissed and the action is declared valid. SECOND:— The defendant recognizes, both in the exceptions set forth as well as in the counterclaim, the role of agent of the companies sued which Josueth Gonzalez, legal predecessor of the plaintiffs had to carry out steps with the Empresa de Ferrocarriles del Estado for studies, financing, providing of materials and executing of the award of contracts in the international bidding contest by said Empresa, within the rehabilitation plan of the Ecuadorian railways and for studies and construction of the Duran-Miraflores oil pipe-

line, since the defendant only alleges that said agent did not fully comply with the *mandato*. On the other hand, at the second instance, the powers conferred upon Josueth Gonzalez by the mentioned companies were presented which accredit the existence of the *mandato*. Furthermore, in the agreement signed in Madrid on December 18, 1968, by Josueth Gonzalez and the Director of Servicio para Exportacion de Material Ferroviario (S.E.M.F.), contained in folios 43 and 44 of the file of the first instance, made up of the companies being sued and which, with the later inclusion of Heredia y Moreno, S.A., made up the Consorcio Espanol which was the awardee of the contracts for the supply of materials, accessories and spare parts for the Empresa de Ferrocarriles del Estado and for the studies and construction of the Duran-Quito oil pipeline, are set "the mutual obligations" among the contracting parties and expressly recognize that Josueth Gonzalez has the role of legal representative of S.E.M.F., before the Empresa de Ferrocarriles del Estado de Ecuador, "for the development and carrying out of the contracts that the companies which make up S.E.M.F. have entered into with that enterprise", as literally appears in the mentioned agreement. It also appears in said agreement that the agent, Mr. Josueth Gonzalez, shall receive as total remuneration for his work as such agent, the amount of thirty three thousand five hundred sixty five American Dollars, in accordance with the conditions and periods of time stipulated in the same agreement. THIRD:— Of the above mentioned amount, the plaintiffs recognize that their predecessor Josueth Gonzalez received 40% or the amount of thirteen thousand four hundred twenty six Dollars, which corresponds to the first installment which the principals agreed to pay of the agreed fee, in accordance with the stipulations of the often mentioned agreement. FOURTH:— Regarding the second heading corresponding to 10% or the amount of $3,356.50 which should have been paid according to the agreement, "as soon as the approval of the plans and lists of spare parts of all the contracts that are being carried out for Empresa de Ferrocarriles del Estado de Ecuador is given", it is on record that the contracts were definitely complied with, since the Empresa de Ferrocarriles del Estado definitely received, in final form, the ten loco-

motives contracted, the passenger cars and spare parts, even though the plans and lists of spare parts were not approved in complete form; which fact cannot be, in any way, blamed on the negligence or carelessness of the agent. Said facts are proved in the record of this action, especially with the report of the Chief of the Technical and Oil Pipeline Department of the Empresa de Ferrocarriles del Estado, on record at folio 184 of the pleadings. Therefore, the noted omissions did not impede the compliance with the contract and once this was complied with, the agent has the right to the payment of the second stipulated installment, equivalent to the sum of $3,356.50. FIFTH:— The third installment equivalent to 20%, or the amount of $6,174.00, should have been paid at the end of 18 months from December 18, 1968, as stipulated in the referenced contract. As this term has expired, the plaintiffs have the right to such payment. SIXTH:— As for the fourth installment, equivalent to 30%, or the sum of $10,069.50, according to the same contract referred to before, it should be paid at the end of the warranty period which covers the material sent by the sued companies, or at the conclusion of the tasks of the agent as representative of said companies in relation to the contracts. As was already stated in previous whereas clauses, the materials contracted for have been delivered by the sued companies to the Empresa de Ferrocarriles del Estado, the same which have been received by the mentioned company according to what is on record in the report presented by the Chief of the Technical and Oil Pipeline Department of the company; and if said materials have not been delivered in the quality contracted or the deliveries were subject to delays, said facts can not be attributed to the fault of the agent, such as to deprive him of the right of receiving his fee for his services as such. Therefore, he has a right to the mentioned payment. SEVENTH:— As to the counterclaim set forth by the defendant party, it can not succeed since it has not been shown in the action that the agent did not comply with his obligations as stipulated in the contract; and, as to the offer that the agent made in the contract, regarding the possibilities of effecting new sales of railway equipment to Ecuador that he should inform and give preference to the companies he represented, under new economic conditions, in

the event that such a contract be worked out, if it is of record that Josueth Gonzalez presented an offer to the Empresa de Ferrocarriles del Estado for the sale of passenger cars for trains manufactured by a company other than the ones represented by him, said fact does not deprive him of the right to charge his fee, since such a sanction was not established in the contract; and, even in the event that the plaintiffs were harmed by this fact, they are not justified, even more since there is no proof that the offer mentioned above had been accepted. EIGHTH:— As to the appeal of the plaintiffs, we hold that Art. 7 of the *Ley de Regimen Monetario* is applicable, since we are not dealing with an international transaction, but to a contract of *mandato* entered into between a foreign company and an Ecuadorian individual, for which reason the exception set forth in literal a) of Art. 8 of the same law cannot be applied to the case, as the plaintiffs wish. Therefore, as has been held in the decision which has been appealed, since the fee was stipulated in foreign currency, there has to be a conversion to Sucres, as set forth in the above mentioned Art. 7. As to the interest rate, the plaintiffs demand the payment of the legal amount [of interest] from the citation with the complaint to payment. Said legal interest was 6% per annum at the date on which the complaint was served, for which reason corresponds the payment of the above mentioned interest rate as is set forth in the appealed decision; for, even though the *Junta Monetaria*, by means of *Resolucion* No. 755, published in the *Registro Oficial* No. 728 of January 23, 1975, raises such type of legal interest to 8%, this is only applicable to those acts and contracts (*actos y contratos*) entered into from the date of its validity, in other words from January 23, 1975, according to what is set forth in Art. 8 of the mentioned resolution. As for the costs being claimed, in accordance with what is set forth in Art. 370 of the *Codigo de Procedimiento Civil*, the order to pay costs in all the instances is applicable when the party has litigated in bad faith, which assumption is not the case here, for which reason such order is not proper. Based on the considerations expressed, ADMINISTERING JUSTICE IN THE NAME OF THE REPUBLIC AND BY AUTHORITY OF THE LAW, all the parts of the decision appealed are upheld. Without the costs of this

instance, since both parties appealed.—Notify.—s) Drs. Luis R. Gomez T., Gustavo Hidalgo M. and Estuardo Hurtado L.—

This is an exact copy.
The Secretary
(signature)

EXHIBIT G

TRIBUTARY CODE

Art. 25.— [The] responsible [person].— [The] responsible [person] is the person who, without being a taxpayer, by express disposition of the law, must comply with the obligations attributed to him. All tributary obligations are joint and several between the taxpayer and [the] responsible [person], however, saving the right of the latter to claim restitution for what has been paid for the taxpayer, before an ordinary court and in a summary verbal judgment.

Art. 28.— Other responsible persons.— The following shall also be responsible [persons]:

1. Retaining agents, understanding as such, natural or juridical persons who, by reason of their activity, function or employment, are in a position to retain taxes and, by legal mandate, regulatory disposition or administrative order, are obligated to do so.

   They shall also be retaining agents, heirs and, in a proper case, executors for the tax corresponding to the bequests; but the obligation of the executor shall cease when the duty ends without the bequests having been paid; and

2. Receiving agents, understanding as such, natural or juridical persons who, because of their activity, function or employment and by mandate of law or regulation, are obligated to collect taxes and turn them over to the active subject.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

C.A. No. 76-421-JRR

PHOENIX CANADA OIL COMPANY LIMITED,

Plaintiff,

v.

TEXACO INC., GULF OIL CORPORATION, (now by change of name, Chevron U.S.A., Inc.), TEXACO PETROLEUM CO. & ECUADORIAN GULF OIL CO.,

Defendants.

AFFIDAVIT

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

ALYS KREMER, being duly sworn, deposes and says:

1. I have been a paralegal for the law firm of Kaye, Scholer, Fierman, Hays & Handler since August, 1976. I was graduated from Vassar College in May, 1976 with a Bachelor of Arts Degree in Spanish language and literature. I am fluent in the Spanish language, including reading, writing and conversing. I have translated many of defendants' and plaintiff's trial exhibits in the above-captioned action.

2. I submit this affidavit to certify that I have translated completely and accurately the Affidavit of Dr. Miguel Andrade Varea on the law of Ecuador which was sworn to on December 9, 1986.

/s/ ALYS KREMER
Alys Kremer

Sworn to before me
this 15th day of
December, 1986

/s/ FREDERICKA J. GERMAN

Notary Public

FREDERICKA J. GERMAN
Notary Public, State of New York
No. 03-4806208
Qualified in Bronx County
Certificate Filed in New York County
Commission Expires 9-30-88

APPENDIX D

Letter Opinion of Rene Bustamante Munoz (June 11, 1985)

D1

PEREZ, BUSTAMANTE Y PEREZ
[Letterhead]

Quito, June 11, 1985

Mr. Victor P. Muskin
Gruen, Musking and Thau
Attorneys of Law
500 Fifth Avenue
New York, N.Y. 10110
U.S.A.

Re: Phoenix Canada Oil Co.
vs. Texaco your letter
of April 30, 1985

Dear Mr. Muskin:

The Ecuadorean legal system with respect to rates of interest is as follows:

The Civil Code mentions three kind of interest:

Conventional
Legal
Current

The indemnification in case of delayed payment of monetary obligations is equivalent to the conventional interest if it has been agreed to pay an interest higher than the legal one, or, on the contrary, the legal interest is due.

Current interest is the one that is charged in the market and practically is at the same rate that the "highest conventional rate authorized according to the law".

Formerly, in case of delayed payment, the same rate of conventional interest agreed to be paid before maturity was also due after maturity.

In 1968 a conventional rate of 12% per annum was authorized in case of delayed payment.

Since 1970 an additional rate of 2% was added to the conventional rate as a penalty in case of delayed payment.

In 1982 the additional rate was increased to 4%.

The debtor incurs in delayed payment since the term agreed for payment has expired or the agreed condition has occurred and the payment has not been made; or, for lack of agreement, since a judicial reconvention, or the complaint asking the payment before a court, has been summoned to the defendant.

The Monetary Board of the Central Bank of Ecuador is the governmental body competent to determine the highest conventional rate authorized according to the law.

In the past, the Civil Code had a provision fixing the rates of legal interest due for lack of agreement between the parties and it was lower than the highest conventional authorized according to the law.

For instance, according to the Civil Code, the legal rate from 1871 to 1932 was 6% per annum and the "highest conventional rate" was 12% during the same period.

In 1932 this rate was reduced to 6%. Later it was rised to 10% and afterward to 12%.

At the present time and since 1970, according to the Law of Monetary Regime, the Monetary Board determines also the rate of legal interest.

Starting from 1970, the rates in force have been the following:

	Highest Conventional rate per annum	*Additional for delayed payment per annum*	*Legal rate (For Lack of agreement) per annum*
1970 Regulation 545 R.O. 355 Jan 23/70 in force since Jan 23/70 Civil and Commercial Codes (delayed payment)	12%	+2%	6%

1975 Reg. 755 R.O. 728 Jan 23/75 In force (8%) since Jan 29/75	12%	+2%	8%
1982 Reg. 1170 R.O. 158 Jan 11/82 In force since Jan 17/82	15%	+4%	15%
1983 Reg. 061 R.O. 455 Mar 19/83 In force since Mar 25/83	16%	+4%	16%
1983 Reg. 125 R.O. 608 Oct 27/83 In force since Oct. 19/83	19%	+4%	19%
1984 Reg. 175 R.O. 773 Jun 26/84 In force since Jun 16/84	21%	+4%	21%
1984 Reg. 214 R.O. 90 Dec 20/84 In force since Dec. 11/84	23%	+4%	23%

Therefore, according to these regulations, it is possible to claim interests at the legal rate as indemnification of damages for delayed payment or underpayment of royalties or other monetary obligations. If the claims were summoned to the defendant in November 1976, interests are recoverable at a rate of 8% from November 1976 to Jan 17/82; from this date, 15% until March 25/83; 16% until Oct 19/83; 19% until Jun 16/84; 21% until Dec 11/84 and 23% from Dec 11/84 until the present date.

The same rates of interest are recoverable since late 1978 for the case of claim as to the 1977 participation.

If you require any explanation do not hesitate to write me.

Very truly yours,

/s/ RENÉ BUSTAMANTE MUNOZ
René Bustamante Munoz

medb/51059

APPENDIX E

Excerpts from Affidavit of Michael A. Schwind on the Law of Ecuador Sworn to July 29, 1983

E1

UNITED STATES DISTRICT COURT
DISTRICT OF DELAWARE

Civil Action No. 76-421

PHOENIX CANADA OIL COMPANY LTD.,

Plaintiff,

vs.

TEXACO INC., GULF OIL CORPORATION, TEXACO PETROLEUM COMPANY and ECUADORIAN GULF OIL COMPANY,

Defendants.

AFFIDAVIT OF MICHAEL A. SCHWIND ON THE LAW OF ECUADOR

STATE OF NEW YORK)
COUNTY OF NEW YORK) : ss.:

MICHAEL A. SCHWIND, being duly sworn, deposes and says:

1. I reside at 11 Fifth Avenue, New York, New York 10003.

2. My qualifications to make this affidavit on certain aspects of the laws of Ecuador are as follows:

—From 1942 to 1948 I attended the Faculty of Law of the Central University of Ecuador in Quito. I received from said school the degrees of Licenciado in Social Sciences and of Doctor of Jurisprudence. In 1949 I was admitted to the Bar of Ecuador and thereafter practiced law in Quito, Ecuador.

—In 1951 I moved to New York and attended the School of Law of New York University. I received the degrees of LL.B. and LL.M. (in International Law). In 1957 I was admitted to the Bar of New York. I am also a member of the Bar of the United States District Court for the Southern District of New York, the United States

Court of Appeals for the Second Circuit and the United States Supreme Court. From 1957 to 1964 I practiced law in New York City at the firm of Curtis, Mallet-Prevost, Colt & Mosle. During the same period of time I was an adjunct member of the Faculty of New York University School of Law.

—In 1964 I became a full-time member of the Faculty of New York University School of Law. My title since 1967 has been and now is Professor of Law. In addition, from 1968 to 1971 I was Director of the Inter-American Law Institute and the Institute of Comparative Law of said Law School. I teach in the field of comparative law, specifically a course entitled Introduction to the Civil Law (intended for American students) and an introductory course to the Anglo-American legal system for Civil law lawyers pursuing graduate studies at said Law School. I also teach Conflict of Laws.

—Since joining the full-time faculty of New York University School of Law I have also been a consultant to various law firms, mainly on matters relating to the laws of Latin American and other Civil law countries. As part of this activity I have given expert opinions on such laws for use in judicial proceedings in the United States.

—For many years I have been a member of the Board of Editors of the American Journal of Comparative Law and of the Board of Directors of the American Association for the Comparative Study of Law. At various times I have also been a member of the Board of Directors or an officer of the American Foreign Law Association. Presently I am a Vice-President of said Association.

3. I am familiar with the facts and issues involved in the above-encaptioned action having read the opinion of this Court, dated April 8, 1983; the Magistrate's Report and Recommendation, dated December 11, 1981; the 1978 opinion of this Court published in 78 F.R.D. 445; the affidavits on the law of Ecuador of Dr. Roque Bustamante Cardenas, sworn to, respectively, December 4, 1980, March 24, 1981 and May 21,

1982, as well as the affidavits on the same subject of Dr. Jose M. Rumazo, sworn to February 18, 1981, and Dr. Rene Bustamante Munoz, sworn to July 21, 1982. I have also read in the Spanish original the contract dated July 16, 1965 between Minas y Petroleos del Ecuador, S.A. (hereinafter "Minas") and Compania Texaco de Petroleos del Ecuador, C.A. and Gulf Ecuatoriana de Petroleos, S.A.; the Notarized Instrument (described as "Deed" in these proceedings) dated February 23, 1966 executed by Minas, Compania Petrolera Pastaza, C.A. and Compania Petrolera Aguarico, S.A., as well as the codes, statutes, decrees, decisions and all other writings or documents hereinafter mentioned. All translations herein, unless stated otherwise, have been made by me.

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19. Ecuadorian judges, like those of other Civil law countries, must interpret the enacted law. Article 18 of the Ecuadorian Civil Code establishes guidelines for such interpretation. It provides that when a provision of law is clear, it must be applied literally; when the law is not clear, the judge may consider the intention clearly expressed in said provision or its properly proven legislative history. For purposes of interpretation of a provision of law recourse may also be had to the context in which the provision appears and even to other laws, especially if they deal with the same subject matter. A law may not be expansively or restrictively interpreted because of its "appealing or repulsive" nature. Only if, after applying the above rules of interpretation, the meaning of a provision is still ambiguous, or different provisions of law appear to be contradictory, the enactment may be interpreted in a manner which appears to be in accord with the general spirit of the legislation and natural equity. In that task the judges will be guided by decisions of the higher courts and the writings of commentators.

20. Though previous decisions are not binding in Civil law countries, their reasoning may be persuasive. In the absence of previous decisions, even the highest court of a country will normally not radically extend the reach of a provision by analogy.

It is only by a line of cases tending towards the same result, using the same reasoning, that an expanded application of the law will emerge step-by-step and be judicially accepted.

MICHAEL A. SCHWIND
Michael A. Schwind

Sworn to before me this
29 day of July, 1983

ARDEN COHEN
Notary Public

Arden Cohen
Notary Public, State of New York
No. 314709221
Qualified in New York County
Commission Expires March 30, 1984